S. HRG. 98-1160

UNITED STATES-JAPAN TRADE: THE $30 BILLION GAP

HEARING

BEFORE THE

SUBCOMMITTEE ON
EAST ASIAN AND PACIFIC AFFAIRS

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

OCTOBER 3, 1984

Printed for the use of the Committee on Foreign Relations

U.S. GOVERNMENT PRINTING OFFICE
39-861 O WASHINGTON : 1985

S381-17

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UNITED STATES-JAPAN TRADE: THE $30 BILLION GAP

WEDNESDAY, OCTOBER 3, 1984

UNITED STATES SENATE,
SUBCOMMITTEE ON EAST ASIAN AND PACIFIC AFFAIRS
OF THE COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:45 a.m., in room SD-419, Dirksen Senate Office Building, Hon. Frank H. Murkowski (chairman of the subcommittee) presiding.

Present: Senator Murkowski.

Senator MURKOWSKI. I now call the hearing to order. The Foreign Relations Committee Subcommittee on East Asian and Pacific Affairs will begin this morning to hear a variety of views on United States-Japan trade.

First of all, I want to apologize that more of my colleagues are not with us this morning. I suspect they are with us in spirit, if not in presence. The Senate was in session until approximately 3 o'clock this morning, so if I do not seem as bright and chipper as I normally do, gentlemen, why, you will understand.

At this hearing we will take a look at the ever-increasing imbalance of trade between our two nations. In the United States this year, the bilateral deficit is expected to soar above $30 billion, up some $22 billion from 1983. We will look at the causes of the problems, the efforts that are being made to right the imbalance, and the effect of trade frictions on our overall relationship with our friendly neighbors in Japan.

We are fortunate to have with us this morning the administration witnesses who are on the front lines, so to speak, trying to resolve United States-Japan trade difficulties. We will hear first from the Honorable Under Secretary of State for Economic Affairs, W. Allen Wallis. He has just recently chaired the United States-Japan Economic Sub-Cabinet Consultations, including the Energy Working Group, and we are looking forward to his report on that meeting.

We will then turn to Ambassador Michael Smith, Deputy U.S. Trade Representative, who oversees much of the day-to-day negotiations with Japan.

Under Secretary of Commerce for International Trade, the Honorable Lionel Olmer, will give the subcommittee a perspective based upon his long and personal interest and involvement with Japan in both public and private capacities.

We have three distinguished public witnesses who will represent and present their testimony after we have heard from the administration's panel. They are: Hugh T. Patrick, who is the R.D. Calkins

professor of international business at Columbia University; Nat Thayer, who has just returned from Japan some 3 weeks ago, is an associate professor and director of East Asian studies at the Johns Hopkins University; and Mike Mochizuki, who will be our last witness of the morning. He is assistant professor of political science at Yale.

We will convene again this afternoon at 2 o'clock and we will turn to several expert witnesses to explore the question: Can coal help bridge the trade gap with Japan? We will be joined by Senators Alan Simpson and John Warner, who hopefully will be properly rested by then. Both are experts on the U.S. coal industry and coal exports.

After they have completed their testimony, we will hear from two industry representatives: Michael McCoy, who will represent the Getty Mining Co.; and Connie Holmes, who will express the views of the Coal Exporters Association, of which she is the executive director.

Before we begin, I would like to point out an important report released September 17th and written by another group of experts from both the United States and Japan. The report, entitled "Challenges and Opportunities in United States-Japan Relations," contains a number of excellent recommendations. Without objection, I order that the executive summary of that report be printed in the hearing record at this point.

[The material referred to follows:]

Executive Summary

Managing the Relationship

The United States-Japan bond is strong because the two countries share a wide range of common interests and attitudes. No two countries possess the essential ingredients of a vital bilateral partnership—economic, political, and security ties—in greater degree than the United States and Japan. There are few areas of basic conflict.

In general, Japanese and Americans appreciate the need for a strong relationship and maintain highly positive attitudes toward the other country. Looking ahead, it appears likely that the United States and Japan will continue to develop close security cooperation and increased economic interaction.

Nevertheless, an unacceptable level of friction is eroding good will and mutual trust between the two countries. Issues tend to become politicized before sufficient effort has been made to resolve them at an administrative level; debate on relatively minor issues has diverted attention from more fundamental questions; and too often each side blames the other where internal adjustments may be the answer.

At government and business working levels, seemingly endless trade frictions, differences with respect to the political process, bureaucratic coordination and policy implementation, and impatience with the other country's government-business relationships have produced frustration.

Improving the management of the relationship is a key challenge facing the leaders of the two countries.

- In order to realize longer-term goals, the President and Prime Minister should establish and periodically review a priority agenda that addresses the pressing issues pending between their countries.

• In view of the importance of the relationship, the President and Prime Minister should take overall responsibility in their respective countries for developing policy toward the other country. They should ensure that these policies are consistently pursued and that their negotiators speak with one voice. We applaud the decision to have authority in the United States for the day-to-day coordination of policies toward Japan vested in the Secretary of State.

• In both countries there should be ample provision for input from the private sector in the policymaking process.

• Improved mechanisms are needed, especially in Japan, to ensure effective implementation of commitments.

• Japan should establish a Special Commission on Japan's Agenda for Strengthening the International Economy to develop its own agenda of external and internal tasks rather than react to foreign pressures.

• Occasional joint meetings of the Secretaries of State and Defense and Minister of Foreign Affairs and Director General of the Japan Defense Agency, as well as regular meetings of the Under Secretary of State for Political Affairs and Deputy Minister of Foreign Affairs, should be held for integrated discussion of regional and global issues.

• Japan and the United States should help advance a new GATT round to deal with trade issues multilaterally; Japan should develop a multilateral-trade initiative consisting of specific proposals, while the U.S. Administration should seek more flexible authority for its trade negotiators.

• While most disputes should be resolved bilaterally, Japan and the United States should not hesitate to use international dispute-settlement mechanisms and should work to make these mechanisms more efficient.

Economic Relations

The Trade Flow

The growing trade imbalance is one of the most important causes of friction. There is no sign that the deficit is diminishing in absolute terms, and the trend has been for Japan's exports to the United States to grow more rapidly than U.S. exports to Japan.

This growth in the bilateral trade imbalance mirrors the overall trade performance of the two economies. It reflects global imbalances in the trade and current-account figures for both the United States and Japan, and is a serious factor affecting the political health of the bilateral relationship. Accordingly, both governments should give the matter priority attention. It is principally at the macroeconomic policy level that the respective trade problems of the two countries must be addressed.

- The United States needs to reduce its budget deficit to help lower interest rates and reduce the overvaluation of the dollar, which is hurting U.S. exports worldwide.

- Japan should play a more positive role in stimulating world economic recovery by increasing its own growth rate and reducing unprecedented high trade and current-account surpluses.

- Regular consultation on broad trade and capital-flow questions should be strengthened.

Market Access

It is in Japan's own national interest to make the further opening of the Japanese market a high priority, and to play a leading role in supporting a more open world-trading system.

Although Japan has made a series of unilateral trade concessions, there remain specific difficulties to market entry in Japan which call into question Japan's commitment to free or fair trade.

Some of the systemic problems underlying complaints include difficulty in obtaining access to information on Japan's bureaucratic policymaking and implementing processes, a strong bureaucratic tradition conducive to a reactive rather than initiative policy, and a propensity for Japanese to make a distinction between insiders and outsiders.

The "trade package" approach by Japan in recent years, whereby accumulated issues are resolved through periodic compilations of action measures, illustrates a reactive approach, which has become increasingly less effective. We recommend a more positive approach.

- Improved market access should be made a national goal, based on the presumption that trade should be free unless a compelling argument can be made for restraint.

- Office of Trade Ombudsman (OTO) should become an action-oriented agency to ferret out trade barriers and deal more effectively with complaints. Japan should consider giving this office a strong positive mandate to initiate market-opening measures.

- Japan and the United States should work together to make sure that policies affecting international trade are openly formulated and implemented. Opportunities should be provided for foreign firms to present their views on impending changes affecting their interests.

- Japan should develop effective, internationally credible procedures for monitoring implementation of its policies in such areas as market-opening and capital-market deregulation.

- Whenever possible, market-access questions should be dealt with on an industry-to-industry basis, minimizing the role of government.

Positive efforts by Japan to open its markets must be matched by a more positive U.S. export strategy at both governmental and private levels to take advantage of new opportunities. The United States also has barriers to market entry which should be reduced,

although in view of the generally more open U.S. market, Japan cannot expect full reciprocity for its market-opening measures.

Agriculture and Forestry

Agricultural trade disputes, particularly over the access of U.S. beef and citrus products, are among the most difficult to settle of all bilateral trade disputes.

The two governments should support pragmatic, incremental, but continuous steps to increase agricultural trade. The United States should acknowledge the importance of rice culture to Japan, while Japan should actively take steps to expand farm size and shift the structure of agricultural production toward products that can be efficiently produced on smaller-sized holdings.

- It is imperative that the disparity between the Japanese domestic and world price of rice be reduced.

- The United States should provide additional assurances of continued access to its food supplies.

- Both governments should cooperate to develop through new GATT (General Agreement on Tariffs and Trade) rules governing agricultural trade and the resolution of related disputes.

- It may not be politically feasible to set a fixed schedule for total liberalization of the agricultural sector, in particular beef and citrus imports, as well as forestry products, but a continuing liberalization process should accompany long-term Japanese agricultural adjustment. A binational committee of private-sector experts should be considered to meet regularly and make recommendations for further liberalization.

- Arbitrarily restrictive health and quarantine measures that are not scientifically justified can serve to restrict agricultural imports and should be avoided by both governments. A joint scientific commission should be established to monitor health and quarantine issues and provide guidance to governments in dealing with crises.

Services

Innovation and rapid evolution are characteristic of the rapidly growing service industries and present unique opportunities to spot potential conflict in advance and prevent it.

- Both governments should strive to conform with the principle of nondiscrimination and to maximize open markets.

- National regulations governing services should take into account trade considerations and not interfere with free-trade principles.

- The two countries should cooperate in developing rules in GATT to govern trade in services, but without waiting, should reduce barriers bilaterally.

- Measures such as expanded functions for Office of Trade Ombudsman which facilitate trade in goods, should be extended to trade in services.

Exchange Rates and Capital Markets

The misaligned yen-dollar exchange rate has been a key factor contributing to the growth of the bilateral trade imbalance. Improving the exchange rate should be an important goal of the two countries' policymakers.

- U.S. economic policies should seek to reduce high interest rates that contribute to the overvalued dollar.

- The two governments should cooperate in curbing sharp, speculative exchange-rate fluctuations, without interfering with fundamental market forces.

- Japan should continue to internationalize the yen, expeditiously implementing and further building on the May 1984 agreement between the U.S. Treasury and the Ministry of Finance.

• Japan should continue the process of liberalizing its capital market, including elimination of remaining intervention in interest rates.

Investment

Direct cross-investment assists market access and the flow of technology. Although such investment should primarily be based on market conditions and individual company decisions, it should be encouraged as a significant measure that helps to defuse bilateral trade friction.

• Reciprocal investment opportunities are not being fully exploited. The private sector in each country should more actively explore direct cross-investment opportunities.

• To prevent misunderstandings, the United States should develop clear criteria governing the application of national-security restrictions on investment.

• Unitary tax systems of state governments in the United States can discourage new foreign investment and inequitably treat existing investments. The recommendation of the U.S. Government's Worldwide Unitary Taxation Working Group that unitary taxation be limited to operations in the United States should be expeditiously implemented.

Industrial Policy

Arguments are frequently heard that Japan's trade competitiveness is attributable to unfair industrial policies that call for retaliation or that the United States should emulate policies accounting for Japan's success. We have concluded that:

• Both countries have what can be termed industrial policies.

- Japan is more inclined than the United States to intervene in the free-market process and to design policies, legislation affecting industry, etc., with long-term comprehensive concepts and foreign trade consequences in mind.

- Each country is free to adopt its own mix of domestic policies, provided they are compatible with existing international rules.

We recommend that:

- Government-sponsored cartels, whether for product development or restriction of output, should be open to foreign firms, and not aimed at limiting foreign competition; their operation should be subject to full disclosure.

- The United States and Japan should take the lead in a GATT framework to establish a fair-practice code on cartels.

- The United States should consider revising laws such as antitrust legislation to enhance international competitiveness, while continuing to assure domestic competition and protect consumer interests.

- Joint government and nongovernment working groups, including labor union participants, should study and exchange views on productivity and labor-management relations.

Energy

Cooperation on energy must have a solid economic base, and present circumstances of relatively plentiful energy supply provide an excellent opportunity to consider options for long-term cooperation.

- As existing contracts for coal and liquefied natural gas (LNG) expire and as domestic demand grows, Japan should look to the United States for assured, stable, long-term supplies, assuming mutually satisfactory commercial arrangements can be made.

• A joint feasibility study on Alaskan North Slope gas should be expeditiously undertaken.

• The export of Alaskan oil in a crisis should be considered, striking a balance between political and economic factors.

• A long-term nuclear energy cooperation agreement should be concluded promptly. The United States should not ask more of Japan than it does of other close allies; Japan should be willing to set a world example for safeguards.

• Both governments should collaborate on nuclear-waste disposal and policies governing nuclear-technology exports to third countries.

• Industry-to-industry cooperation should be pursued in the development of the next generation of nuclear technology.

Global Peace and Security

Diplomatic Dimension

The similarity of international interests and the growth of Japan's international role present the U.S.-Japan partnership with new opportunities for productive diplomatic cooperation.

• The rapid military buildup of the Soviet Union is a major concern to both of us, but we both seek constructive dialogue in recognition of the need to coexist. We must continue to consult closely on trade, credits, technology transfer, and resource development as they affect Soviet relations. Common interest in arms control also requires close consultation, as Asian aspects of negotiations have become more significant.

• Stability on the Korean peninsula will remain vital to both Japan and the United States. The effectiveness of the United States security treaty with the Republic of Korea (ROK) is enhanced by Japan's political and logistical support for the U.S. commitment as well as by Japan's economic assistance to the ROK.

• The United States and Japan should assist China's modernization efforts, while avoiding conflicting policies in regard to technology transfer and credit terms. Both countries should respect China's nonalignment but expand dialogue to explain our respective views and encourage a greater degree of international involvement on the part of China.

• The economies of the ASEAN nations are among the world's most dynamic. To further prospects for continued economic growth, the United States and Japan should make every effort to ensure them continued access to their respective markets.

• The United States and Japan should continue to support private and government initiatives that encourage the development of the sense of community that has developed among the states of the Asia-Pacific region.

• Japan's relations with Western Europe lack the political dimension well established between the United States and Japan. Expanded political consultation through liaison with European institutions should be conducive to mutually supportive policies by Japan, the United States, and Western Europe.

• A strong identity of fundamental interests makes it essential that the United States and Japan continue to consult closely on Middle East policy, even if our approaches may not always be synchronized.

• In recognition of the strategic significance of Central America and the Caribbean to the United States, Japan should use political and economic influence to bolster the prospects for regional stability there and in Latin America as a whole.

In pursuing diplomatic cooperation:

• Consultation should allow for the full expression of each other's views and not be limited to notification of actions taken.

• The close coordination advocated above is not intended to suggest a preemptory approach that ignores the interests of other nations.

• Despite the convergence of their national interests, the United States and Japan must recognize that specific policies will not always be identical. There are areas where one or the other has greater influence and where exploration of possible political initiatives should be encouraged as long as it is not counterproductive to common goals.

Defense

In response to increased Soviet capabilities and Japan's growing realization that its security interests extend far beyond its shores, a positive coordination of defense roles and missions for the United States and Japan has been developing. We applaud the determination of successive Japanese Prime Ministers to fulfill Japan's plans to assume primary responsibility for defense of its territory and air and sea environs, and participate in the defense of sea lanes, with the United States providing such supplementary forces as are required. Nonetheless, Japanese capabilities fall short of the demands of the missions it has undertaken. Moreover, a gap remains in public thinking on strategy, with Americans placing more emphasis on military aspects and Japanese emphasizing nonmilitary aspects.

• Japan's defense effort should be justified to attain performance capabilities and overcome defense deficiencies; sterile debate over defense spending per se should be avoided.

• The United States should continue defense-modernization efforts, not only to match Soviet capabilities, but to show it is not asking greater allied effort only to lessen its own defense burden.

• Consultation between our two countries should embrace a wide range of strategic issues, e.g., arms control, and might be expanded to explore initiatives in the field of confidence-building measures. Willingness to keep lines of communication open to the Soviet Union can underscore our common purpose of war avoidance.

• Japan should be prepared to participate in multilateral peacekeeping operations through logistical and personnel support.

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The extent of present Japanese defense efforts and support for U.S. Forces in Japan is insufficiently appreciated by Americans, but areas remain where cooperation could be further improved:

- Japan and the United States should pursue joint research and development of advanced defense systems.

- Purchasing major new systems already in production directly from the United States, rather than manufacturing through licensed production in Japan, may considerably reduce costs for both countries.

- The United States and Japan should work bilaterally and through COCOM to stop detrimental transfers of technology.

- Opportunities should be sought to expand exchange programs and training at service schools for U.S. and Japanese officers.

- In view of the disparity in the defense burden of our two countries, Japan should continue to increase spending that contributes to the effectiveness of U.S. Forces and to Japan's security.

U.S.-Japan defense cocperation is in the mutual interest of both countries and should not be linked to trade issues. Americans need better to recognize the larger security role Japan is playing through economic assistance to vulnerable countries, but Japanese need better to appreciate that foreign assistance can only complement, and not substitute for a greater Japanese self-defense role.

Third World Stability

Given their shared concern for progress in the developing world, the United States and Japan should take the lead in structuring a comprehensive program entailing trade, credits, and development-assistance.

• The United States and Japan should sustain support for the Generalized System of Preferences and expand access for developing-world exports.

• It is essential that the current debt crisis be carefully managed. Japan and the United States should work together to assure adequate capital flows to developing countries through continued credits, private-investment flows and development assistance. Our support should be based on the willingness of recipient countries to adopt sound economic policies, assuring that they make effective use of aid.

• Japan has notably expanded its overseas development assistance, but there is room for qualitative and quantitative improvement, including further aid to strategically critical areas.

• The United States and Japan should enhance the impact of their individual bilateral-aid efforts by identifying additional areas where they can coordinate or dovetail projects.

Science and Technology

The scope of public and private scientific and technological cooperation between the United States and Japan is unique. There is now an excellent qualitative balance in the flow of technological ideas between the two countries.

To further capitalize on our individual strengths and develop expertise in additional areas, we recommend that:

• There should be a review of the thirteen government-to-government agreements to determine possible improvements and new directions.

• Japan should take a stronger role in the generation of basic knowledge, while the United States should devote greater attention to new-product innovation and production technology.

• Joint efforts between U.S. and Japanese high-technology firms should be encouraged, particularly where initial costs of product development are high.

• A variety of measures, including increased Japanese-language training for Americans, should be taken to enlarge opportunities for scientists from both countries to work together and have improved access to each other's research.

• A joint advisory body should examine technical-standards development in the two countries for purposes of harmonization.

Communication

We should recognize that competition stems from the dynamism of the relationship and need not be looked upon as a matter of winners and losers. We need to develop a greater sense of community of interests and better understanding of each other's political processes and room for maneuverability. Japan should cease to cite its uniqueness as an impediment to taking internationally needed policy responses. With the number of persons actively involved in bilateral relations constantly growing, we must have knowledgeable players drawn from the best talent available.

• The U.S.-Japan bilateral dialogue should be opened up beyond a relatively small number of "internationalists" to include more parliamentarians, local politicians, labor and agricultural leaders, etc.

• Japanese corporations and government agencies send many promising future leaders abroad for advanced degrees, language training, and experience. American corporations and government agencies should follow this example.

• The U.S. educational system provides far too few opportunities for education about Japan and Japanese-language training; the Japanese system is preoccupied with emphasis on entrance examinations. These shortcomings should be overcome.

As the two leading free-world economies, Japan and the United States must increasingly look to each other to advance their international goals. Were we to look inward, we might avoid some of the problems inherent in commercial exchange and competition, but we would invite slower growth. On the other hand, if our two nations, accounting for more than a third of mankind's total output of goods and services, work along with others sharing similar interests and ideals, we will vastly improve the well-being of both our peoples and the whole global community.

Senator MURKOWSKI. One of the most important findings of the report is that the deficit "is a serious factor affecting the political health of the bilateral relationship." Accordingly, the two governments should in my opinion give priority attention to this matter.

A simple solution to the deficit would be for Japan, of course, to sell less here in the United States, but I think an even better solution would be for Japan to buy more from the United States. Energy is an area where the potential is obviously the greatest.

I look forward to exploring the issues in depth today, and I want to thank you gentlemen for being with us. And I would ask, Secretary Wallis, if you would like to begin.

STATEMENT OF HON. W. ALLEN WALLIS, UNDER SECRETARY OF STATE FOR ECONOMIC AFFAIRS

Mr. WALLIS. Thank you very much, Senator. I have submitted a long and fairly comprehensive statement for the record, but rather than take up time by reading that and maybe not having enough time for questions and discussion, I will read just a very brief summary of it.

Senator MURKOWSKI. Your entire statement will be entered in the record.

Mr. WALLIS. Thank you.

The President's historic trip to Japan last November successfully emphasized the preeminent importance of our relationship with Japan. Japan's economic power and growing international role has made it one of the most important countries in the world. While problems in our trade with Japan attract attention, and legitimately so, and sometimes generate controversy, our overall policy transcends these issues.

There are three principal components to our relations with Japan: First, we seek to achieve a close mutual relationship on a basis of equality; and second, because of our combined economic and technological impact on the world, our relationship has grown global in scope; and third, Japan is becoming increasingly assertive in global matters and is forging a wider international role for itself.

It is difficult to discuss Japan without going to extremes. One extreme focuses on important immediate problems, such as friction caused by a particular problem in trade. This runs the risk of ignoring historic trends and very real contemporary and future benefits. The other extreme overemphasizes these benefits at the expense of becoming insensitive to important American interests. We must avoid both extremes in our handling of this complex and important relationship. Either extreme risks eroding the goodwill and mutual trust between the two countries which is so important, not only to the United States and Japan, but to the prosperity and political stability of the Pacific basin and indeed of the whole world.

Calm, consistent attention to issues before they are politicized should work to eliminate the cyclical and emotional swings in our relationship. We have attempted to do just that. We must build upon this approach so that future generations of leaders will not be so estranged by the battles that a mature dialog and the accom-

plishment of other important objectives in our relationship become increasingly difficult.

We have to remember that we have a remarkable democracy and a strong and stable partner in a distant part of the world, a partner whose contributions to our common interests have grown enormously over the past decades and whose contributions are certain to grow even more in the future.

Now, we continue to have serious trade problems with the Japanese. Real progress, nonetheless, was made during the followup to the President's visit last November. In the aftermath of the visit, both sides engaged in intensive discussions on critical outstanding issues, and from that process and the negotiations that preceded it we agreed, for example, on a new NTT [Nippon Telephone & Telegraph] arrangement, which we hope will lead to expanded sales of U.S. equipment; new beef and citrus agreements, which will increase our sales of these products; tariff reductions for certain products of interest to the United States; and a delay in Japanese legislation that would have removed computer software from copyright protection. There are other issues on which we have agreed to continue to work.

In order to pursue our objective of approaching problems constructively rather than confrontationally, we have established or reinvigorated the wide-ranging, all-encompassing consultations and negotiations with Japan that exceed those that we have with any other country. Just to name a few, we have the High Technology Working Group, the Energy Working Group, the Investment Committee, the Industrial Policy Dialogue, the Trade Committee, the Capital Markets Group, the Trade Facilitation Committee, the Forest Products Group, the Beef and Citrus Group, and the Working Group on Standards.

In the week of September 13 to 21, we held talks with the Japanese on high technology, investment, industrial policy, energy, and all trade issues. These meetings culminated in the semiannual Sub-Cabinet Consultations, which I chair, to review all economic aspects of our relations.

The consultations have served as an excellent forum to let the Japanese know at a high level and in a comprehensive manner our concerns and priorities, to head off issues before they become severe problems, and to approach outstanding issues in a manner most likely to reach an agreeable resolution.

Under the Sub-Cabinet Consultations are the Trade Committee, the Investment Committee, and the Energy Working Group. The latter two were established at the time of the President's trip in November. Though other groups formally do not report to the Sub-Cabinet, we in fact do cover all pertinent issues.

The Economic Sub-Cabinet Consultations are broad-ranging and, because we hold them regularly, they are fairly freewheeling. All U.S. Government agencies which are directly involved in United States-Japan economic relations participate, including the USTR and Commerce, whose representatives are here today.

We do not feel it necessary to beat around the bush about the points we want to make. Together we try to figure out what can be done to solve problems and to minimize friction. More importantly,

we try to look ahead and head off problems before they become too serious.

In the meetings just concluded, we talked about the multilateral financial institutions and the trading institutions and our role in them—what can we do jointly to strengthen them? We also covered outstanding bilateral subjects. In addition, there was some talk about the looming record trade deficit with Japan, which is estimated in 1984 to be above $30 billion. And while we seek to eliminate all obstacles in Japan's markets to competitive U.S. products, I doubt that the deficit would disappear even if Japan were to remove all barriers to trade in the Japanese market.

There are no easy or quick fixes. Furthermore, elimination of the bilateral trade deficit is not an objective in itself. Rather, the objective is to make sure that we and the Japanese are playing by equal rules and to secure the mutual benefits of open markets. Our policy is to keep our markets open, to open Japan's markets, and to work with Japan to bring other countries into a new round of trade liberalization.

With particular regard to energy, the administration's efforts during the past year to expand our energy relationship have been useful. The joint policy statement gives the governments of both countries a clear framework in which to encourage their respective private sectors to find ways to increase energy trade. We created forums where governments and private businesses can talk frankly, and the talks have been frank.

The continuing task of the U.S. Government is twofold: first, to do all we can to encourage continued contact between the private sectors; and second, to stress to the Japanese Government our seriousness with respect to increased energy trade.

While we have a long way to go, the basic premise is shared by both governments. An expansion of energy cooperation will strengthen the overall economic ties between our two countries. It would reduce the trade deficit, and it would contribute to increased energy security.

The challenge that we face is to make sure that when we deal with Japan on individual issues we keep our overall interests in mind and utilize the importance of our relationship, both bilaterally and internationally, to achieve progress on outstanding issues. Our trade interests are important to us, but they are not the only part of our relationship; and conversely, our security interests in Japan are extremely important to us, but this does not mean that we should downplay our interest in securing equitable access to Japan's markets.

We should not pursue one aspect of our relationship to the exclusion of other aspects. To attack the overall relationship or to characterize it as being to one side's advantage only, on the basis of a single issue, is something like tearing up the lawn to get rid of a dandelion. Our relationship with Japan is without question one of our most important and vital relationships, and it will be increasingly so in the future.

If we keep the overall importance of that relationship in mind, we could make even greater progress in resolving outstanding issues.

Thank you very much, Mr. Chairman.

[Mr. Wallis' prepared statement follows:]

PREPARED STATEMENT OF
THE HONORABLE ALLEN WALLIS
UNDER SECRETARY OF STATE FOR ECONOMIC AFFAIRS
BEFORE THE SUBCOMMITTEE ON EAST ASIA AND PACIFIC AFFAIRS
OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

OCTOBER 3, 1984

It is a great pleasure for me to appear before you today to discuss one of our nation's most important relationships--that with Japan. These hearings can make a major contribution to illuminating the importance of this relationship, the problems and opportunities within it, and to bring not only the Congress but also the American people up to date on where we stand and where we are going.

I know that you are primarily interested in the bilateral trade relationship, and I know that my other colleagues will speak to that in detail. Today I would like to present my testimony around three themes--trade, security and international cooperation--which give a broader view of U.S.-Japan relations. It is within this context that our trade relationship must be seen.

Our Relationship with Japan

The President's historic trip to Japan last November successfully conveyed the preeminent importance that we attach to our relationship with Japan. Given its economic power and its growing international role, Japan clearly has become one of the most important countries in the world to us. While bilateral trade problems attract significant attention, legitimately so, and often generate considerable controversy, our overall policy towards Japan transcends these issues and encompasses three approaches:

-- First, we have worked to achieve a close bilateral relationship with Japan, as an equal partner. The past decade has brought a significant expansion of Japan's economic and technological prowess; an increase in its defense awareness and capability; and a greater interest and involvement in international political and economic affairs. Of course, there still are differences in our relative political, economic, and military positions in the world. But we approach and conduct our relationship as equals.

-- Second, because of our combined economic and technological impact on the world, our relationship has grown

global in scope. This was the theme of Secretary Shultz's landmark Shimoda Speech last September, when he referred to our new relationship with Japan as an "international partnership." While our partnership in the past has been measured primarily in economic and technological terms, in the future it will have a larger political dimension as Japan assumes a greater international role and associates itself more actively and closely with the political and security goals of the West.

-- Third, Japan is becoming increasingly assertive in global matters and is forging a wider international role for itself. During most of the post-war period, Japan played an international role quite similar to that which was followed throughout most of American history--pursuing economic interests while eschewing political involvement. But particularly since the events in Iran and the Soviet invasion of Afghanistan in 1979, the Japanese have come to realize that their own well-being is affected directly by political and security developments elsewhere in the world. The implications are clear--the days of "economic giant, political pygmy" are over. The United States encourages this trend toward a broader international political and economic role by Japan, within the framework of a continued close bilateral relationship.

When people look at U.S.-Japan relations, the focus often is on the problems in our relationship and not on its successes. I believe that if we look at our overall relationship, we find that it is the best that it has ever been. The problems are the exceptions, not the rule.

Developments During the Past Three Years

The past three years have been some of the most active periods in U.S.-Japan relations. The President's meeting with Prime Minister Nakasone in London at the Summit marked their fourth meeting in 18 months. Secretary Shultz and Foreign Minister Abe have met a total of 14 times--most recently just this past week during the UN General Assembly. The President, the Vice President, and nearly every member of the President's Cabinet have visited Japan. This type of dialogue is producing movement in all aspects of our relationship. Let me turn specifically to our trade relationship.

Trade Relationship

We continue to have well-publicized problems in bilateral trade. Even though difficulties in access and market penetration remain, the Japanese market is more open now to

most American products than it was at the beginning of the Administration. In general, as Senator Percy pointed out in his recent Journal of Commerce article, many U.S. businessmen agree that Japan has made efforts to open its market; the direction is right but the pace is frustratingly slow.

Although full market opening continues to be our goal, Japan now is actually our largest external market, except for Canada. Last year, it bought $23 billion worth of American products, equal to our exports to France, West Germany, and Italy combined. Japan is our best overseas market for agricultural products, yet only one-fourth of our exports to Japan are in that category. About 20 million acres of U.S. farmland are used to produce crops that are purchased by Japan. There is more land under cultivation in the U.S. for the production of food which goes to the Japanese market than there is in Japan itself. In fact, in 1983, the Japanese bought more U.S. beef than any other country--about 64% of our total beef exports. And this was before the U.S. and Japan finally reached a four-year agreement on April 7 of this year that will allow the U.S. to more than double beef and citrus exports to Japan during the life of the agreement. When this agreement ends in four years, Japan will be taking about 80% of all U.S. beef exports. Japan also is the single largest foreign customer for U.S. coal.

Japan also is a major market for U.S. manufactures; in fact, it buys more manufactures from us than West Germany does. Japan is our first or second largest market for a wide range of manufactured goods such as chemicals, commercial aircraft, photographic supplies, medical and scientific equipment, and pharmaceuticals. In addition, Japan buys $10 billion worth of American services from us, and we run a surplus with Japan in services trade.

Beyond that, Japan has increasingly invested in the United States. This direct and portfolio investment creates employment, helps finance our Government's deficit, and makes money available for our banks to lend to American companies and consumers. The Japanese government estimates that private investment in the U.S. currently stands at about $14 billion, and accounts for about 70,000 jobs for Americans. In 1983, Japan transferred $5.5 billion in direct and portfolio investment capital back to the U.S., over three times the 1982 level of $1.7 billion.

The point is that we have a fundamentally sound economic relationship with Japan and we have been making progress in increasing our access to Japan's markets. We will continue to address trade problems diligently as they arise. The size and complexity of our trade--$63 billion in two-way merchandise trade in 1983--make it impossible to avoid completely trade problems in the future, especially as both countries develop their potential in new products and services.

If we take a historical look at our trade relations with Japan, we see this to be true. In the 1950's, we were concerned about clinical thermometers, one dollar blouses, and cotton typewriter ribbons. In the 1960's and 1970's, the products shifted to textiles, color TV's, and specialty steel. Today, we worry about computer software, telecommunications equipment and services, and fiber optics.

While working to achieve greater market access for specific products and services, the Administration has also begun to deal with the underlying issues in the Japanese economy and industrial structure that limit our access to Japan's market. In order to accomplish this we have established or reinvigorated the wide-ranging, all-encompassing bilateral mechanisms for consultations and negotiations with Japan that exceeds that which we have with any country. We have, just to name a few, the High-Technology Working Group, the Energy Working Group, the Investment Committee, the Industrial Policy Dialogue, the Trade Committee, the Capital Markets Group, the Trade Facilitation Committee, the Forest Products Group, the beef and citrus group, the Working Group on Standards--and there are others. We just completed, in the September 13-21 period, talks with the Japanese on high-technology, investment, industrial policy, energy and all trade issues. These meetings culminated in the semi-annual Sub-Cabinet consultations, which

I chair, to review all economic aspects of our relations. The consultations have served as an excellent forum to let the Japanese know at a high level and in a comprehensive manner our concerns and priorities, to head off issues before they become severe problems and to approach outstanding issues in a manner most likely to attain an agreeable resolution. Under the Sub-Cabinet consultation umbrella are the Trade Committee and the Investment Committee, the latter established at the time of the President's trip in November to promote and facilitate two-way investment. Though other groups formally do not report to the Sub-Cabinet, we generally have no difficulty covering all pertinent subjects.

The Economic Sub-Cabinet Consultations are broad-ranging and because we hold them regularly, they are fairly free-wheeling. All USG agencies which are directly involved in U.S.-Japan economic relations participate, including USTR and Commerce, whose representatives are here today. We do not feel it necessary to "beat around the bush" about the points we want to make. Together, we try to figure out what can be done to solve problems and to minimize friction. More importantly, we try to look ahead and head off problems before they become too serious. In the meeting just concluded we talked about the multilateral institutions, the financial institutions and the trading institutions and our role in them--what we can do

jointly to strengthen them. We also covered outstanding bilateral subjects.

At the Sub-Cabinet meeting, held last February in Tokyo, we sought ways to capitalize on the results achieved by Prime Minister Nakasone and President Reagan during the President's visit to Tokyo last November. There have been a number of steps in Japan, generally favorable steps from our point of view, since that Sub-Cabinet meeting, and during our consultations this month we discussed those at some length--generally liberalization of either tariffs or laws that restricted American imports, or particular aspects of financial arrangements which have been liberalized to a considerable extent.

During the past two years, the Japanese Government has announced three trade packages that seek to reduce trade friction and increase our ability to compete in the Japanese market on a fair and equitable footing. By far the most significant of these packages from an American point of view was that announced on April 27 of this year. Specifically, our interests included beef and citrus quotas, tariffs, high-technology issues (renewal of the NTT agreement, unimpeded access to telecommunications value added networks, protection of computer software, and satellite procurement), energy

cooperation, general investment questions. This package was broadly responsive to our interests, although we were disappointed that certain items, such as tariff cuts on forestry products, were not included.

The main elements of the April 27 package are:

-- On market access, Japan promised to take additional steps to simplify and improve standards and certification systems, to promote imports, and to accept foreign test data.

-- On tariff reductions, Japan indicated that tariffs for a number of products of interest to the United States will be abolished or reduced in Japan Fiscal Year 1985. As I indicated earlier, there were no cuts on forest products, a major economic and political disappointment.

-- On tobacco, legislation passed by the Diet that privatizes the Japan Tobacco and Salt Public Monopoly Corporation, which will give U.S. companies the right to import and distribute tobacco products on their own account, and to set their own prices with Ministry of

Finance approval. The tobacco item is a bright spot in the package which could significantly expand opportunities for U.S. products.

-- On agricultural quotas, a satisfactory new four-year bilateral beef and citrus agreement was reached April 7, which will lead to an approximate doubling of U.S. exports to what already is our largest overall market for these products. An Agreement on liberalization of quotas and on tariff reductions for several other agricultural categories, such as fruit juices, was reached April 24.

-- On high technology issues,

o computer software: The GOJ agreed not to seek new legislation during this session of the Diet, thereby effectively continuing existing copyright protection. The package notes the need for "international harmony" and indicates that Japan will not take any further action on this issue without coordinating the viewpoints of the other developed countries. We will continue to consult on this key issue so that copyright protection will be continued.

o telecommunications: The package refers to legislation which will liberalize the telecommunications market in Japan. The package commits the GOJ to ensure simplicity and transparency in its notification procedures and fair competition between the new, privatized Nippon Telephone and Telegraph (NTT) company and other telecommunications firms. These changes will be a major step forward for an open Japanese telecommunications market. Implementation, however, will be important and we will follow it carefully.

o satellites: Japan revised its satellite procurement policy, stating that private firms now will be able to purchase communications satellites from any source after the passage of the telecommunications legislation.
Furthermore, when NTT is privatized, the GOJ states that it will open the way for purchases of satellites in a non-discriminatory way, while ensuring consistency with its national space development policy. GOJ agencies should be able to procure foreign satellites not necessary for autonomous development of space technology. We have requested

clarification of this policy and intend to continue to press for full open procurement.

-- On energy cooperation, the package repeated the GOJ's agreement to send a Japan coal mission to the U.S. in May and to facilitate private sector interest in Alaskan gas feasibility studies. A Japanese coal mission subsequently came May 14-15 and while there were no immediate results, the two private sectors established an on-going committee to continue their dialogue. This committee met for the first time September 11-12, in Tokyo. In addition, gas and coal feasibility studies have been agreed and should commence in the near term.

-- On investment, the package established an "expediter ombudsman" mechanism to relay investment information, to assist foreign companies wishing to invest in Japan, and to settle investment grievances. The Prime Minister's statement included a clear indication that Japan welcomes direct foreign investment, and the GOJ is sending a mission to the U.S. to promote investment in Japan. I might point out in this connection that the Japan Development Bank is now making low-interest loans available to foreign companies investing in Japan, even for sales offices for U.S.-made products.

-- On other issues, the package stated that the GOJ will work with the Japan Federation of Bar Associations to reach an early resolution of the lawyers issue (e.g., agreement for foreign lawyers to practice in Japan). It is noteworthy that reference to the lawyers issue was included, as we believe it commits the GOJ to show concern and responsibility for a matter that legally is under private jurisdiction.

As I stated earlier, this Administration, through the bilateral mechanisms developed with the Japanese, has addressed not only specific issues but also so-called "generic" problems. These generic problems can be characterized as follows:

-- Standards Laws Reform: In terms of its direct and long-term impact on a wide range of U.S. exports, Japan's reform of its standards and product approval laws is one of the most significant actions that it has taken in recent years. As the door opens wider, we hope more American companies will take advantage of those fundamental changes. At the same time should problems arise we want to be alerted so that both sides can work to deliver the full potential of this opening.

-- Transparency: The gradual movement toward transparency in Japanese procedures and decision-making also will have a long-term impact. Basically, in a number of ways, Japan is moving toward a "sunshine law" approach, allowing U.S. firms to participate in actions that affect their access to and ability to compete in the Japanese market on an equal footing. The Japanese Government has agreed to transparency in a number of ways over the past two years. For example, as indicated above, U.S. firms can now make their views known in developing Japanese standards; in addition, Nippon Telegraph and Telephone (NTT) has agreed to procedures which should allow U.S. firms to participate in its R&D work; and the President of the American Chamber of Commerce in Japan has been invited to testify before a Japanese Diet committee, as have representatives of USTR, Commerce, and the U.S. Embassy. We hope for additional moves toward greater transparency in the future and we will continue to work for them.

-- Capital Market Liberalization and Internationalization of the Yen: In the Regan-Takeshita statement of last November, Japan agreed to further liberalize its capital markets and to promote a greater international role for the yen. The report on yen/dollar exchange rate issues, approved by Treasury Secretary Regan and Minister Takeshita and released on May 29, commits Japan to a number of important measures with

far-reaching foreign exchange and other implications. As the measures are implemented, Japan's capital markets will be more open than those of any other country in the world except the U.S. The yen should increasingly play a role in international finance commensurate with Japan's status as the second largest industrialized democracy. The yen's value, as determined by international markets, will reflect the underlying strength of the Japanese economoy. The process of financial liberalization is underway. The most recent step was approval for three U.S. banks to deal in Japanese Government bonds.

Of all of these measures that deal with Japan's underlying economic structure and approach toward imports, we believe that the most significant action over the past three years, and the action that will have the greatest long-term impact, is Japan's movement toward greater liberalization of its domestic capital markets and a broader international role for the yen. Senate resolution 135 of 1983 expressed the view that the dollar-yen relationship should be raised with Japan. This reinforced the Administration's ongoing work in this regard and a landmark agreement resulted. The current exchange rate has the effect of making Japanese goods more price competitive compared to U.S. products not only in the U.S. and Japanese markets, but also in third country markets, thereby affecting our global trade balance. While experts do not expect the yen to appreciate immediately against the dollar, given other

factors, we believe that over the longer term the yen should appreciate, because of Japan's economic strength and political stability. Furthermore, U.S. investment in Japan will be encouraged because a wider range of instruments will be available to finance such investment.

-- High Technology: In order to deal with issues in the cutting edge of technology, we use the high technology working group. It serves as an "early warning system," seeking to head off trade and investment problems before they arise. Far from being solely a forum for discussion, it already has concrete successes to point to, such as Japanese agreement on an import promotion program for semi-conductors and agreement on the mutual elimination of tariffs on semi-conductors. The excellent working relations established between U.S. and Japanese participants in this group have enabled us to make good progress in retaining copyright protection for computer software. A unique feature of this group is that American and Japanese industries, such as the semi-conductor sector, participate in the meeting with government officials. Industry-to-industry contact thereby is facilitated.

-- Industrial Policy Dialogue: We have instituted discussions with Japan on industrial policy, trying to determine how Japan's industrial policies work and the extent

to which they may distort trade. We believe that these discussions already have provided us with a better understanding of Japan's industrial policies, and at the same time have impressed clearly upon the Japanese the concern we have with any industrial policies that may inhibit trade. I hope that out of this dialogue will come mutual understanding of the role of government in promoting industrial development and a joint commitment that industrial policies should not have trade-distorting effects.

-- Energy Cooperation: Another step which will have a long-term impact on our economic relationship with Japan is the joint statement on energy cooperation issued during the President's trip. In this, Japan commits itself to consider seriously trade and investment in U.S. energy resources--particularly coal and LNG. Both governments committed themselves to facilitate private sector contact so that cooperation, and trade, can be expanded.

The U.S.-Japan Energy Working Group just met on September 21 to review where we stand. We pointed out to Japan that increased use of coal, particularly U.S. coal, can improve Japan's energy security and the U.S.-Japan trade balance. We registered serious concern about the unfavorable propsects for developing coal trade and the absence of specific ideas for

increasing it in the near and mid-term. We emphasized the importance of a productive dialogue between the U.S. and Japanese private sectors.

We recognize that in the end, market forces will be the determining factor in Japan's decisions to invest in and buy U.S. energy resources. We should expect no overnight miracles. The slide in total Japanese imports of metallurgical coal has stopped at 13.5 million metric tons, at least for the moment. We hope to keep our present market share for metallurgical coal, but this by itself will not mean increased exports. Technological improvements and structural change in the Japanese coal industry will continue to dampen demand for coking coal.

There should be a gradual increase in demand for steam coal, as the Japanese continue to switch away from oil in electrical power generation. However, coal will not be used for all of that new capacity; nuclear energy will be used as well. Accordingly, we think that Japan will buy about half a million metric tons of our steam coal this year, and that the annual volume may rise slowly by 1990. If the Japanese build coal-fired power plants, the potential market for our steam coal could be larger in the 1990s. Of course, much will depend on price. We also will face staff competition from other coal

suppliers. We will continue to urge the Japanese to examine the economic viability of switching from oil-fired power plants soon. We must note, however, that a coal-fired plant occupies much more land than oil-fired plants of the same generating capacity; this is a serious problem in a crowded, mountainous country like Japan.

The Administration's efforts over the last year to find ways of expanding our energy relationship have been useful. The Joint Policy Statement gives the governments of both countries a clear framework in which to encourage their respective private sectors to find ways to increase energy trade. We created a forum where the private sectors of the two countries can talk frankly; and they have been frank. The continuing task of the U.S. Government is two-fold: first, to do all we can to encourage continued contact between the private sectors; and second, to stress to the Japanese government our seriousness of purpose with respect to increased bilateral energy trade. While we have a long way to go, a basic premise is shared by both governments: an expansion of energy cooperation will strengthen the overall economic ties between our two countries, reduce the trade deficit, and contribute to increased energy security.

The Bilateral Trade Deficit

The primary factors accounting for our enlarged trade deficit with Japan, simply put, are faster growth in the U.S. than in Japan and the high value of the dollar relative to the Japanese yen. These two factors have stimulated demand in the U.S. for imported Japanese consumers products.

We have a large trade deficit with Japan, amounting to $19 billion in 1983, in a total two-way trade in goods of about $63 billion. There are estimates that the 1984 trade deficit could be above $30 billion. I doubt that the overall size of the deficit would disappear even were Japan to remove all barriers to trade in the Japanese market. There are no easy or quick fixes regarding our deficit with Japan. Furthermore, elimination of the deficit is not an objective in itself. Rather, the objective is to make sure that we and the Japanese are playing by equal rules, and secure the mutual benefits of freer trade as equal partners should. We will continue to seek ways of reducing the deficit and we think that the accomplishments of the follow-up period, particularly the internationalization of the yen, will, over time, contribute to that end. We have made our choice--keep our markets open, seek total access to Japan's markets, and work together to bring other countries into a new round of trade liberalizaton.

Security Relationship

As I indicated at the beginning, it is important to keep in mind that U.S.-Japan economic and trade relations are only one facet of the relationship. There is also defense cooperation which is in the mutual interest of both countries.
Japan today has the eighth largest defense budget in the world, and the fourth largest among all U.S. allies. That budget has increased consistently over the past several years, even while other government budget allocations across the board have been frozen or even cut.

Last year, for example, while Japan's overall budget was limited to an increase of just 0.5%, the defense budget increased by 6.55%. The proposed budget ceiling for next fiscal year is even higher, at a little over 7%. Defense expenditures will almost certainly continue to receive preferential consideration in the compilation of the budget. Although expenditures for social security, education and public works have been cut in real terms because of stringent fiscal conditions since the end of the 1970's, defense appropriations over the past three years have increased annually at a rate of about 4% in real terms.

Japan's war experience bred a deep and emotional reaction on the part of the Japanese public against what is sometimes called the "military way". In the forty years since the end of the war, that feeling has not significantly changed, and is supported by Article 9 of Japan's constitution, which, alone among the constitutions of the world, renounces the use of force to settle disputes and prohibits the country from possessing offensive military capabilities. The United States respects these constitutional limits and, while we have urged the Japanese to do more to accomplish the roles and missions they have set for themselves, we have no intention of asking Japan to assume an offensive capability. Nor do we intend to ask the Japanese to assume any regional military security role or to substitute for American military presence in the region. We urge the Japanese to enhance their ability to defend themselves. As the Japanese move toward this objective, United States forces will enjoy greater flexibility to respond to situations elsewhere in the Pacific and Indian Oceans.

Japan also contributes financial support for our military and naval presence. They provide the land for our bases rent free. They contribute over $1 billion every year to help maintain those bases, and the Japanese contribution to base support continues to grow both in relative and absolute terms.

Furthermore, Japanese payments to help maintain the U.S. presence on Japanese soil average about $25,000 per U.S. soldier, sailor and airman in Japan per year.

Beyond obvious dollars and cents benefits, the U.S. obtains a value from our presence in Japan that is of essential importance to the preservation of peace in East Asia. Our bases and supply systems located in Japan are irreplaceable. It would cost the United States uncounted billions of dollars to reconstruct such bases elsewhere, even if a suitable area could be found--which it cannot.

In short, we should never make the mistake of thinking that the United States presence in Japan benefits only Japan or that U.S. troops are stationed there only to defend Japanese interests. They are there not only to help defend Japan, but also to defend our common interest in peace and stability in the Pacific region.

International Partnership

Finally, cooperation between the United States and Japan in diplomatic, economic and political interaction with third countries, both industrialized and developing, forms the basis for yet another dimension of the U.S.-Japan relationship, the

dimension I earlier labeled our "international partnership". It is based on the enormous impact on world affairs that our two countries exert, our shared values, and on our common world view and objectives and goals for the future.

The United States and Japan have the two largest and most dynamic economies in the free world, accounting for about one third of total world GNP, 35% of total world trade, and more than 50% of the world's overseas investment. We are the world's technological leaders. In 1982, U.S. and Japanese banks made over 53% of all internationally syndicated loans. The U.S. and Japan are the number one and number three contributors of official development assistance respectively, with combined disbursements last year of around $11 billion to less developed countries around the world. We are the world's first and second contributors of refugee assistance, and the first and second largest shareholders in the World Bank.

The resulting shift in Japan's approach to international relations has had a positive impact on the ability of the West to pursue its objectives of promoting economic development and political stability in less developed countries.

Between 1976 and 1980, the Japanese doubled aid disbursements. They are attempting to double assistance levels

again by 1985. Aside from the defense budget, only the annual aid budget has been exempted from Japan's fiscal austerity. Last year's aid budget increase of 9.7% was by far the highest in the entire budget. This year's ceiling has been set even higher, at around 11%, and will also be by far the largest increase in the Japanese budget. Annual aid disbursements come to over $3 billion, and a growing percentage of this aid is directed outside Southeast Asia, the traditional area of Japanese interest.

For example, Japanese aid to Africa, while still small compared to U.S. or French efforts, is some 52 times greater than it was a decade ago. The Japanese food aid program for Africa is also important. So far this year, Japan has pledged nearly $90 million in food aid to Africa, all of which is on a grant basis. Japan has also contributed to Western interests by providing substantial assistance to such strategically important countries as Egypt, Turkey and Pakistan, none of which are important oil-producing countries but whose security is essential to the security of the Persian Gulf region.

Moreover, since 1982, The People's Republic of China has become the single largest recipient of Japanese assistance, with some $368 million dollars in development assistance for industrial modernization in 1983 and an estimated $315 million

slated for this fiscal year. Japanese aid to the ASEAN countries averages over $1 billion per year.

Concurrent with the enormous expansion of aid activity has come a greater willingness on the part of Japan to become engaged abroad diplomatically. Close U.S.-Japan coordination of our approach to East-West relations across the board has led to enhanced Western solidarity on general Soviet policy and arms control issues, and has also helped to stem to flow of high technology goods to the Soviet Union.

In addition, Japan has worked with us to provide essential diplomatic support for South Korea in the wake of the Rangoon bombing of a year ago and the North Korean proposal for tripartite talks which came, astoundingly, only two days before a North Korean bomb wiped out many of the South Korean cabinet and nearly succeeded in killing President Chun himself. President Chun also recently visited Japan -- the first South Korean President ever to visit Japan.

Japan has worked actively, and with both sides, to prevent escalation of the Iran-Iraq war. As the only Western country maintaining good relations with both sides, the Japanese have a unique and valuable role to play in this regard.

The Japanese have been cooperative on third world debt issues and has extended vital support to the Philippines to aid it in the financial crisis it faces. They have been strongly supportive of U.S. policy in Central America and of the democratic process there and elsewhere in Central America.

The Challenges and Opportunities of the Future

As we look toward the future, the United States has a number of specific policy goals:

-- Strengthen U.S.-Japan cooperation and consultation on a wide range of international political and economic issues in order to promote peace and international security, not just in Asia but throughout the world.

-- Continue to strengthen our mutual security relationship, while stressing the importance of Japan's making a larger and accelerated contribution to our common defense burden.

-- Continue our major efforts to achieve greater and more equitable market access to Japan, and work together to maintain the free trade system and counter protectionist pressures in the U.S., Japan and elsewhere.

-- Consult and cooperate closely with Japan in our mutual efforts to foster an open world trade and investment system, and to promote economic development and financial stability in the developing nations.

-- Continue to expand our educational, cultural, and scientific relations.

As we seek to accomplish these goals, I see three major challenges before us:

-- Supporting with effective policies and actions the commitment by both countries to the free trade system;

-- Ensuring that we treat Japan as we would any other ally and friend; and

-- Using the strength and vitality of the overall relationship to facilitate resolution of any transitory problems.

I mentioned earlier that in the case of defense, we are convinced that Japan is now genuinely and sincerely moving in the direction of an enhanced effort. Japan's intentions or motives are not in doubt. Unfortunately, despite sincere intentions and good motives on both sides, I cannot yet say that

all our trade problems are resolved. There still is a widespread view that Japan is not committed to allowing our companies and products fair and equitable access to its market, and that Japan makes concessions only begrudgingly and under pressure. To quote from the just-released report by the U.S.-Japan Advisory Commission,

> "General public images are important in setting the overall tone of U.S.-Japan relations. It is much more likely that specific trade frictions will become heavily politicized when there are responsive echoes in strongly negative public attitudes." One of the conclusions in this section of the report on perceptions states, "What is of deep concern to us is the fear that continuing trade frictions too often place Americans and Japanese on opposite sides of the table. The appearance of an adversarial rather than cooperative relationship predominating threatens to increase resentment in the government and business communities. This in turn reduces trust, makes future issues harder to resolve, and increasingly affects public attitudes toward the relationship."

The quotations I just used illustrate how perceptions in both countries can lead to pressure and response tactics. This is not the only way to conduct business. Calm, consistent

attention to issues before they are politicized should work to eliminate the cyclical and emotional swings in our relationship. We have with few exceptions attempted to do just that during the past three years. In my view we must build upon this approach so that future generations of leaders will not be so estranged by the battles that a mature dialogue and the accomplishment of other important objectives in our relationship become increasingly difficult.

Particularly in trade matters, I welcome the fledgling indications that some circles in Japan see it as in their own national interest to open their market completely to foreign products and services. The leaders of Japan have to foster this growing recognition. In this regard the Advisory Commission report states that:

> "The Commission considers the further opening of the Japanese market a high priority for the Government of Japan. The primary reason for Japan to improve market access is the same as that for any other country: it is in its own national economic interest to do so. Open markets spur competition, increase consumer choices, improve economic efficiency, and help to hold down inflation."

Prime Minister Nakasone reportedly has directed his Cabinet to study ways to implement the Commission recommendations, specifically noting the trade deficit with the U.S. We welcome this attention and hope for prompt positive results.

In terms of international political cooperation, however, the obligation is more on our side. If we want Japan to work together with us as a close and equal partner on the international stage, we must act accordingly. We must treat Japan as an equal, consult closely, and be willing to listen and in some cases modify our policies and actions when Japan disagrees. In the global economic arena, Japan already is speaking its mind openly to us. However, Japan has been less willing to do the same in international political affairs. I hope that we will be flexible and mature enough to receive it as a sign of a successful policy.

The final challenge that we face is to make sure that when we deal with Japan on individual issues, we keep our overall interests in mind and utilize the importance of our relationship--both bilaterally and internationally--to help achieve progress on those outstanding issues. Our trade interests are important to us, but they are

not the only part of our relationship. Conversely, our security interests in Japan are extremely important to us, but this does not mean that we will or should ignore our interest in securing equitable access to Japan's market. We should not be forced to choose one aspect of our relationship over another. To attack the overall relationship, or to characterize it as being to one side's advantage only, on the basis of a single issue is something like tearing up the lawn to get rid of a dandelion. Our relationship with Japan is without question one of our most important and vital relationships, and it will be increasingly so in the future. If we keep the overall importance of that relationship in mind, we can make even greater progress in resolving outstanding issues.

Senator MURKOWSKI. Thank you very much, Mr. Secretary.

In the interest of time and to accommodate your schedule, I would like to have the remaining witnesses keep their remarks to about 7 minutes, which was what yours was, Mr. Secretary, and then we will have time for questions. And we can, I think, accommodate your time schedule.

Mr. WALLIS. Thank you very much.

Senator MURKOWSKI. Our next witness will be Ambassador Smith. I see we have had a departure, a temporary one I hope. Ambassador Smith, the Deputy U.S. Trade Representative, we welcome you to the committee and look forward to your testimony.

STATEMENT OF HON. MICHAEL B. SMITH, DEPUTY U.S. TRADE REPRESENTATIVE

Mr. SMITH. Thank you, Senator. Like Under Secretary Wallis stated, I have submitted a more detailed statement for the record.

Mr. Chairman, you asked what is our objective toward Japan in trade policy, and in a word it is to achieve equal access. How are we doing? We have made some progress on some issues. We have made that progress by trying to attack the root causes of lack of access across wide sectors.

At the same time, we have sustained our efforts to get at specific problems, and where bilateral discussions have not been fruitful we have gone to the GATT [General Agreement on Tariffs and Trade] to get to the root causes. We have pushed on five major initiatives: the first is standards and certification; the second is high technology; the third is NTT procurement; the fourth is industrial policy; and the fifth is investment.

I would be pleased to get into the specifics during the questions and answers. As you know, the Japanese Government had announced earlier some four packages, which are detailed in my written testimony and I will not go into any depth on those.

The latest series of measures were announced on April 27, and some of those were good news and some of those were bad news. To begin with, two issues on which real, substantive and substantial progress was made involved manufactured tobacco products and telecommunications, particularly the issues of the value added network services.

The two issues that require further clarification of the intent of the Japanese Government are satellites and software. Areas where the issues have only been partially addressed include standards, tariffs, and investments. And two areas which remain unaddressed thus far are legal services and certain agricultural import restrictions. Again, on each of those, sir, I would be prepared to go into detail if you so request.

Our fundamental approach has been much like you have just said, sir. It is to get greater access to Japanese markets and not reducing Japanese access to our markets. A good example of that is the effort that we have made over a number of years in the manufactured tobacco product area, which in Japan has annual retail sales of over $10 billion. If the changes recently announced by the Japanese Government are fully and fairly implemented, U.S. producers of tobacco products should significantly expand their share of that market.

Telecommunications services is another promising sector. The market in Japan for U.S. exporters could be enormous, potentially in the billions of dollars, but our trade imbalance in this growing sector has been steadily increasing.

I would say, sir, in summary that we in the United States have taken the risk of free trade in this country and we are calling on Japan also to take its fair share of the risk of free trade and comparative advantage. From our point of view, competitive imports from the United States must be allowed the same opportunities in the Japanese market that Japanese goods have for so long enjoyed in the U.S. market.

As I indicated in my detailed written testimony, we have made much progress with Japan, Mr. Chairman; but also, that same testimony would indicate that we have important issues on our agenda that remain to be resolved.

And I would be happy to respond to any questions that you might have, sir.

[Mr. Smith's prepared statement follows:]

PREPARED STATEMENT OF HON. MICHAEL B. SMITH

Mr. Chairman:

I am pleased to have the opportunity to appear before the Subcommittee on East Asian and Pacific Affairs of the Committee on Foreign Relations to discuss the Administration's views on current U.S.-Japan trade relations. I will focus my remarks this morning on the current trade agenda between Japan and the United States the outlook for our trade relationship with Japan. In particular, I will highlight the efforts of the U.S. Government to open the Japanese market and encourage the japanese to buy more from the United States. I further appreciate being able to speak to you today in as much as we just conducted last month our latest session of bilateral discussions with the Japanese Government.

United States-Japanese trade relations have been characterized by continuing frictions. These have resulted from the widespread awareness in the United States that while no nation in the world has benefitted so greatly from the U.S. policy of free trade as has Japan, the Japanese market has remained relatively less open to U.S. exporters. That friction has been exacerbated by the continued growth of Japan's trade surplus with this country, which increased from $17 billion in 1982 to over $19 billion in 1983. Our estimate is that that figure may grow to $31 billion or more in 1984.

Over the three and a half years since the Administration took office, we have made securing unfettered access for U.S. ex-

porters and investors in the Japanese market a priority goal of our trade policy. We have engaged in intensive negotiating efforts with the Japanese toward that end. And although important problems remain, we have made substantial progress.

It is important to reiterate that our policy to resolve our trade and investment problems with Japan has been to increase our opportunities to compete -- to export and invest -- in the Japanese market. We have not sought to balance our books with Japan by limiting Japanese access to our markets, nor do we want to.

To take that route would have been politically expedient. It would have quieted the voices of those in this country who would prefer protection to competition. It would have made life easier for those forces in Japan that would prefer "moderation" of Japanese exports to the U.S. to liberalization of their own markets.

But a policy imposing protectionism here and accepting continued protectionism in Japan, no matter how politically expedient such a course might be, would have been deeply damaging to the real economic interests of this nation and to the international system of free trade and competition that we have laboured so long and hard to foster and maintain.

The approach we have taken has been a harder one, but one that has sought economic solutions rather than political expedients. It has had three prongs. First, we have taken steps to get at the underlying root cause of our trade and investment problem with Japan. Rather than deal with the problem as previous Administrations have done, simply on a product-by-product, sector-by-sector basis, we have attempted to find and implement new ways to remove the continuing structural and attitudinal impediments that keep the overall flow of our investment and our exports, especially manufactured exports, to Japan, low.

We have done this by seeking to identify the nature of those impediments and then to create, through intensive bilateral discussions with Japan, a framework for structural change. Under this approach, I would include five major initiatives that we have undertaken with Japan:

-- Negotiation of legal changes in 16 Japanese laws governing standards and certification procedures. Those laws had created onerous and discriminatory procedural barriers to some 60 percent of all U.S. manufactured exports, across a wide variety of sectors.

-- The development, by a joint U.S.-Japan working group, of recommendations for policy guidelines governing trade and investment in the area of high technology. Those guidelines, which have been adopted by both governments, cover measures to open up access for U.S. firms in Japan in the

extremely important and highly competitive field of high technology over a broad range of areas, from research and development to long term supplier-purchaser relationships.

-- The negotiation of a significantly improved agreement to afford U.S. firms access to the huge market for procurement by Japan's telecommunications monopoly, the Nippon Telegraph and Telephone Public Corporation, NTT.

-- An intensive bilateral dialogue on the trade effects of industrial policy, in which our objective has been to identify and seek the elimination of Japanese policies that may be adversely affecting our firms' ability to compete in this market, in Japan, and elsewhere around the world.

-- The initiation of formal bilateral discussions on direct investment policy in order to enhance conditions that will stimulate greater two-way direct investment flows between our countries. This ongoing effort on investment will serve to improve our export position with Japan. In addition, it will help reduce protectionist pressures in the United States by encouraging greater Japanese investment h e r e , which should provide the United States with other benefits, such as increased flows of technology transfer. Such discussions reinforce our general commitment to foreign investment based on market forces.

The development of these approaches of seeking solutions to the root problems that have had wide effects across many

products and sectors has been a prime focus of our principal bilateral trade forum with Japan, the U.S.-Japan Trade Committee, which I chair, and of the U.S.-Japan Investment Committee, which my colleague, Deputy USTR Ambassador Robert E. Lighthizer, chairs. Those committees have also sustained our continuing efforts to identify and remove the barriers to access in specific product and investment sectors. This second prong of our approach has involved many meetings with the Japanese in these committees and in subgroups covering such fields as tobacco, forest products, beef and citrus, tariffs and others. As I mentioned, we have just finished this past month lengthy session of bilateral discussions with the Government of Japan on a wide range of trade topics.

Our efforts have also involved frequent meetings at the Cabinet level. Nearly every member of the Cabinet concerned with trade and investment issues has visited Japan to address these issues since the Administration took office, and particularly over the past two years, including Secretaries Shultz, Regan, Baldrige, and Block. Ambassador Brock has been to Japan twice in the past year, and has met either there or here with the Prime Minister and Ministers of Foreign Affairs, International Trade and Industry, Agriculture, and Finance, as well as with the President of Nippon Telegraph and Telephone Public Corporation, and other Japanese leaders.

Moreover, trade has been a major subject of the discussions between the President and the Prime Minister during their meetings. During his trip to Japan in November of last year, the President stressed both publicly and privately the importance of resolving trade issues. In his speech to the Diet, he emphasized that many Americans believe that Japan has greater access to our market than we have to the Japanese market, and he made a strong call for Japan to join us in combatting protectionism.

To follow up on their discussions, the President and the Prime Minister agreed to set up, after Japan's elections and the formation of a new Cabinet, a high-level bilateral effort to address and resolve the major outstanding issues in trade and defense. The first phase of that followup effort, chaired on the United States side by the Vice President, has now been completed. The outcome of that phase has been the announcement by the Japanese of a number of trade measures, made public on April 27 of this year, along with measures for the liberalization of the Japanese capital market and investment restrictions, made public on May 29. I shall go into the details of the April 27 announcement, as well as briefly review earlier trade initiatives undertaken by Japan, a little later in my testimony.

A third important prong of our approach has been a multilateral one. On the one hand, we have sought to join hands with Japan and other trading partners to strengthen and expand the scope

of the free trading system, and to encourage Japanese leadership in taking the initiative for a new round of GATT. As you know, at the London Summit, Prime Minister Nakasone, with the President's strong support, called for such a new round to begin in 1986.

As a second element of this multilateral focus, we have made increased use of the GATT and the related codes as fora for consultation and settlement of issues with Japan in cases in which bilateral discussions have not resulted in resolution. Last year, for example, we held GATT consultations under Article 23:1 on certain Japanese agricultural import restrictions that resulted in Japan's agreeing to a number of liberalizing actions that are detailed later. We have also taken Japan to dispute settlement under GATT Article 23:2, and this year won a GATT panel decision that found Japan's import restrictions on leather and leather products to be inconsistent with her GATT obligations.

Major Administration Initiatives

Standards and Certification

One of the major initiatives undertaken by this Administration to open up the Japanese market to U.S. products has been a sustained effort to secure the removal of Japanese legal barriers that have imposed discriminatory procedures for product approval. Last year, with the passage by the Japanese Diet of legislation revising some 16 laws governing standards and certification, that effort produced a milestone in our trade relations with Japan that should, when implementation of the legal changes is fully realized at the administrative level, constitute the most significant and wide-ranging removal of formal barriers to the Japanese market since the conclusion of the Tokyo Round of Multilateral Trade Negotiations (MTN).

The passage of this legislation provides U.S. suppliers for the first time with treatment equal to that provided Japanese suppliers during the product approval process. This new national product approval policy came about in response to our strong requests in 1982 after three years of standards-related talks had resulted in no progress and in our filing of a complaint under the Standards Code on the specific case of aluminum softball bats.

The aluminum softball bat was like the nail in the shoe of the horse in the old rhyme, for the resolution of that case produced revisions in laws covering a vast array of imported products: electrical and electronic goods, agricultural and industrial chemicals, consumer products, processed foods, pressure vessels, cosmetics, pharmaceuticals, medical devices, and motor vehicles. Our experts estimate that as much as 60 percent of U.S. manufactured exports to Japan, with a rough value of over $5 billion, could benefit from these standards reform measures.

For U.S. suppliers to benefit fully from these legal changes, an important administrative step remains. That step is the designation by Japanese ministries of American firms to conduct required factory inspections and product testing. If U.S. testing firms are not designated to conduct such testing and inspection, U.S. producers will in many cases be unable to avail themselves of access to the new Japanese system. A first step in this direction was recently taken by the ministry of International Trade and Industry (MITI) when it approved Applied Research Laboratories and Underwriters Laboratories (UL) to inspect the factories of U.S. electrical appliance manufacturers. In a related move, the Ministry of Agricultural, Forestry & Fisheries (MAFF) recently inspected two of Ralston Purina's plants which should pave the way for the company to label its products with the "JAS" mark before shipment to Japan. Similar steps must be taken in other areas and by other ministries.

A working level group of U.S. experts visited in Japan in August to reiterate our ongoing requests on this point, and to review with Japanese officials the guidelines they are preparing regarding the acceptance of test data from foreign testing organizations. In bilateral meetings last month, we again urged the Government of Japan to implement a number of its past commitments regarding the liberalization of these practices.

High Technology Trade and Investment

A second area in which the Administration has formulated a wide-ranging trade initiative is high technology trade and investment. This is a vitally important area for U.S. trade policy, because it covers a broad range of products, from biotechnology and new materials to electronics and telecommunications equipment. Moreover, high technology trade involves a large number of American firms at the forefront of an expanding international market.

U.S. firms in these fields are facing intense competition from Japanese producers, and a good deal of friction has arisen between the United States and Japan over high technology trade and investment issues. An increasingly contentious issue has been the unequal footing on which U.S. firms have been forced to compete in Japan. The impact of this issue is reflected in the fact that Japan is the only nation with which the United States runs a deficit in high-technology trade.

To address this issue, our two governments established the U.S.-Japan Working Group on High Technology Industries. This group, chaired on the U.S. side by the Office of the U.S. Trade Representative and the Department of Commerce, and on the Japanese side by the Ministry of International Trade and Industry, has engaged in intensive discussions on high technology trade and investment issues over the past two years. The Group has produced two sets of recommendations. The first set covers general issues relating to high technology trade and investment. The second set focuses on issues affecting trade and investment opportunities in the semiconductor industry in both countries.

The first set of recommendations, which were approved by the U.S. and Japanese Cabinets on February 10, 1983, consisted of three parts:

-- An affirmation that free market principles should govern high technology trade and investment, and a commitment by both sides to non-discriminatory treatment of foreign companies and to rectification of distortions to trade arising from government policies.

-- A set of concrete steps to alleviate immediate problems, including joint collection of market data, development of a Japanese plan to promote high technology imports, and measures to improve the ability of U.S. firms to license Japanese technology and participate in Japanese Government funded R&D projects.

-- A long-term work program committing both sides to the development of recommendations concerning the impact of government policies on high technology trade.

The Group's second set of recommendations, covering issues in the semiconductor sector, was adopted by both Cabinets last November, during President Reagan's trip to Japan. These recommendations included measures to:

-- eliminate duties on semiconductors in both countries;
-- promote trade in semiconductors, particularly through a Japanese Government program to encourage Japanese semiconductor users to form long-term relationships with U.S. suppliers;
-- promote the removal of barriers to investment; and
-- promote the protection of intellectual property rights against unfair infringement or copying.

The U.S. semiconductor industry has welcomed these recommendations, stating that "they appear to represent a very constructive step forward." And we hope the Conference Committee will act favorably on the administration's legislative proposal to eliminate the semiconductor tariffs which are presently incorporated in HR 3398 (to be updated after legislation is passed). Once the measures are fully implemented, they should provide a substantial stimulus to increased access for our semiconductor exports to Japan.

NTT Procurement Agreement

A third major initiative in our efforts toward Japan has involved another area related to high technology. I refer to the revised agreement that we have negotiated covering procurement by the Nippon Telegraph and Telephone Public Corporation. The vast procurement by NTT of a wide variety of electronics and communications equipment and parts, and its extensive and sophisticated research and development programs, make access for U.S. suppliers to this telecommunications giant an issue of broad significance.

The new three-year agreement, signed on January 30th of this year by Ambassador Brock and Foreign Minister Abe, is one that we expect will enable our highly competitive firms in this field to make substantial gains in sales of sophisticated, network-related equipment to NTT over both the short and long term. Moreover, for the first time, they will have an equal opportunity with their Japanese competitors for participation in NTT's R&D projects.

During the first three-year agreement opening NTT procurement to foreign firms, which expired in December 1983, sales by U.S. firms did increase from about $15 million in 1981 to some $142 million in 1983. But despite the sharp growth, even the 1983 figure accounted for only about 4.5 percent of total NTT procurement,

and fell far short of expectations. Moreover, little of what NTT has procured from American firms has been high technology equipment of the type that is central to the telecommunications network and likely to promote the development of long-term relationships with American suppliers.

Nevertheless, given the importance of being able to compete for a share of the Japanese telecommunications market, which is the second largest in the world, the U.S. industry, with whom we consulted closely during our review of whether to renew the Agreement, strongly supported its renewal.

The revised agreement reaffirms Japan's commitment to open NTT's sizable purchases to U.S. exporters, while strengthening that commitment in a number of ways. Among the improvements incorporated into the revised agreements are commitments by NTT to: treat U.S. and Japanese firms on an equal basis in all of NTT's R&D activities, accept bids in English at NTT's New York office; and aggregate purchases so as to make them commercially attractive to foreign suppliers. The new agreement also mandates annual reviews of NTT's performance in implementing its commitments with the first annual review scheduled to begin on October 4 here in Washington. Our most important criterion for evaluating the agreement's implementation will be the actual level of sales of U.S. firms to NTT. In addition, we will closely monitor the proposed changes in the legal status of NTT, to ensure that

they do not affect the terms of the agreement.

Industrial Policy

The fourth major initiative that the Administration has undertaken in its trade policy toward Japan has been to conduct a dialogue with Japan on the trade effects of industrial policies. Many Americans consider this a key issue in U.S.-Japanese trade relations, and believe that Japanese Government industrial policies intended to promote emerging industries or aid declining ones have the effect of restricting foreign competition in the Japanese market and distorting competition in this country, as well as in third country markets.

In order to determine fully and accurately the facts about those industrial policies and their trade effects, this industrial policy dialogue, known formally as the "U.S.-Japan Committee on Industry-Related Policies and Their Effects on Trade," was established in February 1983 by Ambassador Brock and then Minister of International Trade and Industry Yamanaka.

The dialogue, in which I chair the U.S. delegation, has met seven times, most recently on September 18 here in Washington. We have covered extensive ground regarding the nature and content of Japan's industrial policies and their objectives and implementation. We are now in the second phase of our work, the assessment of the trade effects of those policies. That assessment is

being carried out on the basis of what we have learned so far in the dialogue, our own analyses and those of other studies of the issue. The context of that evaluation is the fact that Japan has the lowest proportion of manufactured products in her total imports of any industrialized economy while her exports of such products have grown into a major force in this market and those of her other trading partners.

In short, our main focus in the dialogue has come to be on securing Japan's answer to a fundamental question: where are the manufactured imports? In the answer to that question, as the Japanese explain their industrial policies' impact and as we make our own independent assessment, will lie the basis for the policy response that we must decide upon.

We have urged the Japanese side in the dialogue to make that answer the basis for action to address both the problem of increasing manufactured imports into Japan and industrial policy planning and implementation in the future. Manufactured imports must play a greatly enlarged role in the Japanese economy in the future if the free trading system is to be maintained and overseas markets for Japanese manufactures are to be kept open. Industrial policies that bar or impede foreign competition in the Japanese market can no longer be ignored by Japan's trading partners, and their continuation is increasingly likely to put Japan's own access to this market at serious risk.

Japanese Trade Initiatives

Mr. Chairman, let me now turn my attention to the series of trade initiatives undertaken by the Japanese Government over the past two and a half years in response to our efforts. I shall briefly summarize the earlier initiatives before going into some detail on those announced by the Government of Japan on April 27, 1984.

Previous Initiatives

The first set of trade initiatives, announced in November 1981, accelerated the timing of tariff cuts agreed to in the Multilateral Trade Negotiations, and established a Japanese Government committee to study opportunities for imports in the Japanese market. One of the results of this group's work was the creation of an Office of Trade Ombudsman, charged with responding to foreign complaints regarding barriers to market entry.

The second set of initiatives, announced in May 1982, included tariff eliminations or reductions on a wide variety of products, among which those on photographic film, cut diamonds and several others were of interest to the U.S. It also contained a commitment by the Japanese Government to undertake a series of "generic" remedies - many of which we had urged for some time, in such areas as customs procedures, and foreign access to participation in the formulation of industry standards. Followup discussions

revealed substantial progress in certain areas, such as customs procedures, but little progress in other areas of particular significance to the United States.

The third trade initiative, contained in announcements made in December 1982 and January 1983, included tariff reductions on chocolate, tobacco products and paper, as well as a commitment to undertake a high-level review of Japanese standards and certification practices. That review led to the changes in some sixteen laws governing those practices in May of last year that I discussed earlier.

The fourth initiative, presented on October 21, 1983, included a number of tariff reductions. Individual cuts were made on some 44 items, of which few were of sufficient depth to offer an appreciable increase in market opportunities for U.S. products. A one year acceleration of rates committed to in the Multilateral Trade Negotiations (MTN) was also made on some 1200 items, a welcome step but one with little actual market opening effect, due to the very small average size of the reductions on products of U.S. interest. The initiative also pledged "steady implementation" of improvements in standards procedures, and promotion of the activities of the Office of Trade Ombudsman.

Most Recent GOJ Trade Initiatives: The April 27, 1984 Announcement

The Japanese Government announced its most recent trade liberalization measures on April 27 of this year, in a document entitled "External Economic Measures." These measures are intended as the outcome of the followup effort to resolve outstanding bilateral issues in trade, investment and energy, to which Prime Minister Nakasone committed his government during the President's November trip to Japan. A separate agreement between the Treasury Department and the Ministry of Finance covering financial measures was announced on May 29.

I am submitting for the record USTR's summary analysis of the measures included in the April 27 announcement, comparing the measures to be taken with the measures we have requested.

A realistic appraisal of these various initiatives, including the most recent one, would have to conclude that, while there has been progress on market access for some products of major interest to the United States, there is still a long list of issues on our bilateral agenda that remain wholly or partially unaddressed.

Even for many of the products on which progress has been made, the greater part of the effect of the initiatives as market opening steps remains to be tested, as legal changes are implemented through the Japanese bureaucracy.

Thus, we now have two types of issues facing us on our bilateral trade agenda. Those issues which the Japanese Government has addressed positively will require continued intensive followup, to ensure that the market opening potential of those positive steps actually materializes. Those issues addressed only partially or not at all will require renewed efforts to obtain resolution.

In the first category are sectors such as tobacco and telecommunications services, in which legal reforms to liberalize the Japanese market are currently underway.

Areas in which the Japanese Government has partially addressed U.S. concerns include standards, tariffs, investment, and capital market liberalization. Areas in which we have sought clarification of the meaning of statements contained in the April 27 announcement include satellite procurement policy and the status and prospects of proposals to change the basis of legal protection for the rights of developers of computer software programs. Areas which remain unaddressed and unresolved include legal services, and import restrictions on agricultural products.

Tobacco Products

One of the areas in which we have made substantial progress, liberalization of the Japanese tobacco market, could provide significant new market opportunities for U.S. exporters.

The Japanese tobacco market, with estimated retail sales in excess of 10 billion dollars, is one of the world's largest. Up until now, U.S. tobacco exporters have faced a government-run pricing and distribution system in this market.

Contained in the April 27 announcement is a series of measures to liberalize the Japanese tobacco market. On August 7, the Diet passed the legislation which should permit increased competition in the Japanese tobacco market, effective April 1, 1985. The new legislation will end the Japanese government monopoly on distribution, enable U.S. firms to set their prices independently of government direction, (although approval of the prices by the Ministry of Finance will be required). In addition, the expansion of the number of retail outlets permitted to handle tobacco products will continue. The reforms in the tobacco sector also include a revision of the excise tax on tobacco products from a wholly ad valorem tax to one with a specific tax component, the effect of which should be to enable a reduction in the retail price of imported cigarettes. It will probably be a year or more before we know to what extent these reforms result in increased market access for U.S. firms.

With respect to the implementation of the legal changes affecting tobacco products, the U.S. Government has been assured that procedures such as price approvals and registration of importers and wholesalers will be neither burdensome nor discri-

minatory. We will be following the implementation of such measures very closely.

Telecommunications

Like the tobacco sector, up until now Japan's telecommunications sector has been an almost wholly closed market controlled by a government-owned monopoly, Nippon Telegraph and Telephone Public Corporation.

Legislation pending before the Japanese Diet would open up that sector to competition among private firms, both Japanese and foreign-owned, effective April 1, 1985.

This is potentially a significant step toward an open market in a major emerging technology sector.

The real value of the market liberalization measures in these two sectors, however, will depend very heavily on the manner in which they are implemented. Bureaucratic procedures, and requirements such as registration for telecommunications services firms, must be framed and implemented in a manner that neither impedes market entry by U.S. firms nor disadvantages them vis-a-vis their Japanese competitors.

Satellites

Satellite procurement is an area which will require continued followup. In discussions with the Japanese, we requested revocation of the prohibition against procurement of imported communications satellites.

In its April 27 announcement, the Japanese Government states that after passage of telecommunications reform legislation by the Japanese Diet, private firms will be able to purchase communications satellites. It stated also that when NTT is legally transformed next April, a "privatized" NTT will be able to purchase satellites either domestically of from abroad, so long as "consistency with the national space development policy" is ensured. Furthermore, the announcement states that government agencies may procure in a non-discriminatory way satellites not necessary for autonomous development of space technology.

The practical effect of this statement will depend on two factors:

First, on the extent to which new purchases by NTT of communications satellites are precluded in the near term by existing arrangements with Japanese manufacturers;

Second, on the criteria the Japanese Government will employ in deciding whether foreign satellite purchases are consistent with Japan's space development program. Ambassador Brock

has requested clarification of those criteria, and during our August and September discussions, the U.S. working group restated its request for such clarification.

Software

A major issue which has yet to be resolved concerns a proposal under review in the Japanese Government for legislation that would abandon copyright protection for the rights of computer program software developers. The proposal would substitute a new, *sui generis* form of legal protection not linked to the established international structure of protection under the aegis of the Universal Copyright and Berne Conventions. It would also shorten the duration of protection and provide for compulsory licensing of software.

The April trade announcement states that the Japanese Government will not submit the proposal to this session of the Diet. The proposal has not been permanently rejected, however, but remains under deliberation. We have informed the Japanese Government of our strong and unaltered opposition to such a measure as inconsistent with Japan's international obligations. The European Community, by the way, fully shares our deep concern and has made very strong representations to the Japanese Government.

Tariff Reductions

Another area in which progress remains to be made is in tariff reductions. Although the April 27 announcement included tariff reductions on several items of U.S. interest, including paper products and wine, farm machinery, color photographic paper, and black and white film, the tariff component of the announcement was disappointing in several respects.

First, none of the announced tariff actions will take effect until next year. This delay in implementation diminishes the potential market opportunity for U.S. exporters. Second, the benefits of the tariff reductions on wine will be somewhat reduced by an increase in domestic Japanese wine taxes.

Finally, several items of major interest to U.S. exporters went unaddressed. A case in point is the lack of tariff cuts on forest products, such as plywood, veneer, and particle board. The fact that forest products were not addressed at all certainly compounds the perception that Japan is reluctant in many areas to open up its markets to competitive U.S. products.

This issue is indicative of a more fundamental problem. It reflects a basic Japanese conception of trade that identifies imports with raw materials like logs and views manufactured products, like plywood, as something that Japan should export. If real progress is to be made on our bilateral trade agenda,

manufactured or processed imports must take on a greatly enhanced role in the Japanese conception of trade.

In August 1984, I presented to the Japanese Government our updated list of tariff reduction requests, including forest products, fresh grapfruit, walnuts, wine, certain paper products, photographic paper, chocolate and non-chocolate confectionaries, and wrought and unwrought aluminum. We urged the Japanese Government to take up these requests at the next meeting of the Tariff Deliberation Council in December, in order that elimination or significant reduction of those tariffs take place effective April 1, 1985.

Investment

Another area in which the Japanese Government has been only partially responsive to U.S. requests is in bilateral investment issues. In response to U.S. requests, the April 27 package includes an announcement that the Office of Trade Ombudsman will be expanded to handle complaints by foreign investors regarding the establishment of enterprises in Japan; and the Japanese External Trade Relations Organization (JETRO) will establish an investment facilitation and information office. Also, the Japanese Government has recently announced the abolition of the "designated company" system which until now allowed the Japanese Government to limit foreign equity participation in selected companies. Further, the Japanese Government has announced

its intention to permit foreign trust banks to enter Japan's growing pension fund market, with rules to be developed by the end of this year.

However, other U.S. concerns and requests about foreign direct investment in Japan have not yet been addressed. The United States requested that the prenotification system in Japan, whereby all foreign investments in Japan must be reviewed prior to entry into the Japanese market, be changed to one which requires only notification to the Japanese Government after the establishment of the foreign investment. However, on the positive side, the Japanese Government recently indicated a responsiveness to U.S. concerns by formally reducing the pre-notification period to only 2 weeks prior to the actual investment; furthermore, they are looking at taking action to further shorten this period. We have also requested precise clarification by the Japanese Government that U.S. investors will be given national treatment in Japan except in national security areas and a few restricted sectors (including mining, agriculture and petroleum refining and distribution). Finally, since foreign investment has been highly restricted by Japan until recent years, we have suggested the value of a broad and detailed statement of Japan's policy toward foreign investors in which national treatment and an open investment climate are spelled out as Japan's policies.

U.S. investment in Japan continues to lag dramatically behind our investment in other countries. Japan ranks only tenth among host countries for U.S. investment abroad, despite the great size and importance of the Japanese economy. The American Chamber of Commerce in Japan (ACCJ) has often cited the presence of companies in Japan as a major necessary element of successful manufactured export sales to Japan. Thus, if Japan is to turn its economy around and spur the growth of manufactured imports, a major effort to spur foreign manufacturing and distribution investment in Japan must also be made.

Last month, the U.S.-Japan Investement Committee met and discussed numerous bilateral issues, including recent developments on status of the Unitary Tax.

Legal Services

Another item on which there has so far been little progress concerns legal services. U.S. lawyers are still not allowed to establish offices in Japan. We will continue to seek changes in Japanese law to afford U.S. lawyers in Japan the right to provide legal advice on U.S. and international law, just as Japanese lawyers in New York are able to provide advice on Japanese and international law.

Agriculture

Agricultural issues have had a prominent place on the U.S. Japanese trade agenda. Recently, we have signed agreements with the Government of Japan that will significantly expand the access of U.S. agricultural products to the Japanese market. Japan uses import quotas to restrict imports of 19 categories of agricultural products. We have spent many months in discussing these quotas, time that would - and should - not have had to be spent, if Japan were living up to its international obligations under the GATT.

In April, Ambassador Brock and Japanese Agricultural Minister Yamamura reached a verbal understanding on interim measures Japan will take between now and April 1, 1988 to significantly increase imports of high-quality beef and citrus. These measures will increase U.S. exports to Japan over that period by at least $400 million.

In late April, we reached another agreement with the Japanese that will increase access to the Japanese market for a wide variety of high-value and processed foods. As I mentioned earlier, a year ago, the U.S. Government began consultations with the Government of Japan under the GATT regarding Japanese import restrictions on 13 categories of products. In return for reduction of these barriers, we will suspend our GATT case for two years. Specifically, Japan will eliminate import quotas on products

such as non-citrus fruit juices, expand quotas on other items, and significantly reduce tariffs on 36 products, including peanut butter, electrodialized whey, and tomato juice. The Government of Japan is already acting to implement these measures.

The Outlook for U.S.-Japanese Trade Relations

These and other issues will be addressed in one or more of the ongoing bilateral groups established by the United States and Japan to handle our trade and investment issues.

Several positive steps have already been taken. The liberalization of the yen is one such measure. Currently, the high value of the dollar relative to the yen contributes to our trade deficit with Japan by making it more difficult for U.S. exporters to sell in the Japanese market, and making Japanese imports more attractive to consumers here. Liberalization of the yen will not in and of itself solve the problem, however.

The fundamental issue, I repeat, is one of greater access to Japanese markets, not of reducing Japanese access to our market. Greater market access will lead to greater export sales by us. These sales could be substantial in many industries in which U.S. manufacturers are competitive. A good example is the Japanese manufactured tobacco products market. Currently, retail sales in that market are in excess of $10 billion. However, U.S. producers account for only 2 percent of that market. If

the legal changes recently announced are fully and fairly implemented, and U.S. producers are allowed to price their products competitively in the Japanese market, we would anticipate a significant growth in exports over the next two years.

Telecommunications services are very likely to be vast international markets. U.S. firms are experienced and enjoy comparative advantage. Hence, the market in Japan for U.S. exporters could be enormous, potentially in the billions of dollars. Despite these factors, U.S. exports in telecommunications to Japan have been declining, contributing to the growing trade imbalance.

The U.S. has put its money where its mouth is. We have taken the risks of free trade and comparative advantage in our own market.

We have been calling upon Japan to take its fair share of those risks. Competitive imports from the U.S. must be allowed the same opportunities in the Japanese market that Japanese goods have for so long enjoyed in the U.S. market.

This is where Japanese leadership in support of free trade, from which she has benefitted more than any other nation, is vital. Japan, to whom so many of the developing countries look as a model of success, will inevitably play the role of exemplar

for their policies.

If, like the United States, Japan's policy is, in deed as well as word, to maintain open markets, then a crucial momentum toward expanding the scope - and strengthening the base - of free trade can be created. If, on the other hand, Japan refuses further to open its heretofore relatively closed markets, then, Mr. Chairman, we will have trade frictions with Japan for the rest of this century. The key for us will be to persuade and cajole the Japanese that it is above all in their own self-interest to take the lead in opening their markets rather than to continue each year to do the minimum on a piece-meal basis. We have some reason to believe that this theme is gradually but surely spreading among a growing number of Japanese leaders. But it remains for Japan's policies and actions hereafter to demonstrate that that recognition of where Japan's true self-interest in trade lies has become a guiding force toward open markets.

Thank you, Mr. Chairman. That concludes my testimony. I'd be happy to respond to any questions the subcommittee might have.

USTR Analysis of Government of Japan April 27, 1984 Announcement

USG request	GOJ response	Comments
TARIFFS		
(A) Industrial: Deep tariff cuts on forest products, paper products, alcoholic beverages, photographic paper, and other items.	(A) Tariff cuts announced as already decided on more than fifty items, of which four—paper products, wine, color photographic paper and hay balers—are from U.S. major request list. Two items from the USG "long list" of requests, raw furskins of mink and unwrought magnesium are included, as is one from an earlier list, auto emission catalysts.	(A) Lack of cuts on forest products one of the major disappointments of the package. U.S. Forest products industry offered its support for a major reciprocal reduction of U.S. tariff on a plywood product in which Japanese exports to the United States are equal to more than four times the value of U.S. exports to Japan of products on which Japanese tariff reductions were sought. Paper tariff cuts are to initially requested levels but effective date on most will be 2 years later than requested. Wine tariff cut reduces maximum ad valorem duty from 55 percent to 38 percent. This is a positive step, but further reductions will be needed. Cuts on color photo paper and black-and-white film, and on hay balers are satisfactory, although again effective a year later than requested. U.S. request on Tennessee whiskey substantially met earlier this year.
(B) Agricultural: Significant cuts on 65 tariff classifications covering a wide range of agricultural products.	(B) Tariff reductions on 34 classifications on which value of imports from the United States in 1982 was approximately $450 million.	(B) No action on high-priority U.S. request for a cut in the tariffs on fresh grapefruit and walnuts. Cuts on six of the items were not requested by the United States and mainly benefit other countries. Action on 12 items being reduced is only an acceleration of the final MTN rate.
(C) Aircraft parts (not a bilateral USG request): In October 1983, GATT committee on Trade in Civil Aircraft requested that its members (including EC, United States, and Japan) pass legislation to increase number of tariff-exempt aircraft parts under the civil aircraft code.	(C) Package states that procedures will be taken to exempt list of requested items.	(C) A positive measure, but one with limited trade impact. Similar U.S. legislation is still pending.

(D) Advanced MTN staging (not a bilateral USG request).	(D) Advanced staging of MTN cuts will be announced; agricultural products will be advanced by 1 year, industrial products by 2 years.	(D) Also a positive measure, although bilateral trade impact is probably limited due to small average size of cuts on products of U.S. interest.
BEEF AND CITRUS		
Significant annual expansion of imports of high quality beef, fresh oranges, and orange juice; easing of other trade barriers on these commodities; elimination of all import restrictions on grapefruit juice; and a commitment to eliminate all import restrictions at some point in the future.	Four-year agreement to expand imports of beef and citrus from April 1, 1984–March 31, 1988. High quality beef quota to increase by 6,900 tons per year. Orange quota to increase by 11,000 tons per year. Orange juice quota to increase by 500 tons per year at 5 to 1 concentrate or equivalent. Grapefruit juice quotas to be eliminated April 1, 1986. Quotas in interim to meet actual demand.	Written document describing Japan's measures has not yet been finalized.
AGRICULTURAL QUOTA CATEGORIES		
Elimination of all import restrictions on 13 categories of Japanese agricultural products. (subject of GATT Article 23:1 consultations).	(1) Eliminate import restrictions on: (A) Prepared and preserved pork products. (A variable levy will be applied on products solely pork.) (B) Hi-test molasses and other sugars. (C) Fruit puree and paste (except citrus, pineapple, peach, apple, and grape). (D) Fruit pulp with same exceptions. (E) Prune, cherry, apricot, berry (except blueberry and strawberry), and tropical (except pineapple) juices. (F) Other food preparations containing added sugar (excluding certain sub categories).	These are measures being taken by Japan to eliminate or reduce import restrictions on 13 agricultural categories. In return, the USG will suspend its GATT case for 2 years. Most of the agricultural tariff cuts noted above are part of this settlement also.

USTR Analysis of Government of Japan April 27, 1984 Announcement—Continued

USG request	GOJ response	Comments
(2) Quota expansion: (A) Dried leguminous vegetables: minimum import quots of $55 million or 120,000 MT in JFY 1984 and 1985. (B) Peanuts: minimum import quotas of about 55,000 MT in JFY 1984 and 1985 with a maximum of about 60,000 MT in JFY 1985. (C) Corned Veg: 50 percent increases (from 500 to 750 MT). (D) Fruit puree and paste: 2,000 MT quota for items not liberalized. (E) Fruit pulp: Quota of 2,000 MT for items not liberalized. (F) Canned pineapple: Quota of 900,000 cases. (G) Non-citrus fruit juice: Grape juice minimum quota of 3,500 MT and 1985. Apple juice minimum quota of 1,000 MT. 1,000 MT quota for juices not liberalized. (H) Tomato juice: 4,500 KL quota in JFY 1984 and 5,000 KL quota in JFY 1985. (I) Tomato ketchup and sauce: 4,500 MT quota in JFY 1984 and 5,000 MT quota in JFY 1985.		

TOBACCO		
Elimination or significant reduction of the price premium on imported cigarettes. Permit U.S. firms to import and distribute their products independently of the tobacco monopoly (JTS).	Package refers to MOF-introduced legislation pending before the Diet that "privatizes" the Japan Tobacco and Salt Public Monopoly Corporation (JTS) and allows independent importation and distribution of tobacco products after registration with MOF. "Pricing policies" to be set by manufacturers with MOF approval; conditions for approval are that: (1) price must be uniform in all parts of Japan; (2) pricing policies do not violate Japan's Antimonopoly laws; and (3) pricing does not constitute "dumping".	A major bright spot in the package which should, depending on implementation by MOF, afford a significantly greater opportunity in this $10 billion annual retail market for the highly competitive U.S. products. Value of this depends heavily on degree to which (1) U.S. firms are in fact free to set their own prices without a MOF veto; we have requested further information regarding the conditions for price approval, particularly that concerning "dumping," in view of the absence of established and transparent GOJ general criteria and procedures dealing with dumping; and (2) registration to import and wholesale is not a burdensome or discriminatory procedure.
	Excise tax will be revised from 100 percent ad valorem basis (on retail price) to include a specific component, in ratio of 80 percent ad valorem, 20 percent specific.	A completely specific tax would eliminate the "tax on tax" effect in which the impact of the tariff is compounded by an ad valorem excise tax. However, this change in excise tax to include a specific component should have effect of enabling a reduction in the retail price of pack of imported cigarettes.
	Package also states that importers will be free to choose retailers to sell their products. Promises efforts to expand number of retail outlets handling imported tobacco will continue to be made while the legislation is still pending.	Such retailers will have to be chosen from those licensed to sell tobacco products; criteria for new retailers to obtain licenses appear to be reasonable.
STANDARDS AND CERTIFICATION		
(A) Japanese ministries designate U.S. testing firms under their approval schemes to conduct required factory inspections and product testing. (Brock to Abe, letter of April 3, 1984.)	(A) Test data from foreign testing organizations which meet certain requirements will be accepted. Clear guidelines setting forth these requirements will be drawn up and published with respect to each certification system by the end of 1984.	(A) Measure is not new or responsive to U.S. request. Measure repeats previous GOJ commitments, such as those in January 1983, trade package and in the March 1983, report of "The Liaison and Coordination Headquarters on Standards and Certification System," etc.

USTR Analysis of Government of Japan April 27, 1984 Announcement—Continued

USG request	GOJ response	Comments
(B) Acceptance by Japanese regulatory ministries of test data generated by U.S. suppliers in the United States according to procedures specified by GOJ. Key product areas of U.S. concern are health care products, (including pharmaceuticals, quasi-drugs, cosmetics and medical devices), industrial and agricultural chemicals, motor vehicles and food products.	(B) Standards for Good Laboratory Practice (GLPs).—GLPs for the testing of new industrial chemical are to be drawn up and published soon. GLPs for agrochemicals will be adopted by March 31, 1985. Foreign clinincal test data for drugs and devices.—Further study to be given, including consultations with foreign countries on ethnic-based physiological differences, and an interim report to be issued by March 31, 1985. Electrical appliances.—Japan has joined an international certification program for electrical appliances and is promoting harmonization with international standards.	(B) No new significant measures. The measures repeat previous statements by GOJ, particularly those in March 1983, report of the Liaison Headquarters.
(C) Japanese ministries should simplify the procedures they use to approve products. In the past, the United States has requested adoption of a "self-certification" process (similar to that used in the United States.) for approving motor vehicles. The United States has also requested acceptance of "accelerated stability test data" for pharmaceuticals while companies conduct "long term stability tests."	(C) The Japanese Government has further reformed the approval processes of two ministries. Regarding motor vehicles, the quantity of vehicles that can be approved under the "low volume exemption" is increased from 300 to 500. Regarding pharmaceuticals, examinations of approvals can start before "long term stability tests" are completed.	(C) Measures may benefit U.S. suppliers. U.S. motor vehicle companies utilize the low-volume exemption and, therefore, an increase could ease the approval process. U.S. pharmaceutical companies seek greater reliance on accelerated test data.

MANUFACTURED IMPORTS PROMOTION		
Public commitment to increase manufactured imports. The Prime Minister was requested to announce a Japanese objective to increase manufactured imports by a specific percentage each year.	(A) Prime Minister Nakasone issued a statement on November 11, 1983 stating that "it is imperative that we make a positive contribution to the development of the individual countries, and the world economy in turn, by expanding the amount of manufactured goods we import from abroad".	(A) The statement did not contain any reference to a specific annual percentage increase nor any other concrete yardstick against which success could be measured.
	(B) Package includes a general statement of implementation of programs to promote market penetration of specific manufactured goods and support of exhibitions of foreign manufactured goods.	(B) The steps announced only go slightly beyond current programs for the support of exhibitions.
SATELLITES		
Immediate revocation of the policy prohibition against procurement of imported communications satellites.	Package states that private firms will be able to purchase communications satellites after the passage of telecommunications legislation currently before the Diet. Package states that if NTT is "privatized," GOJ will open way for NTT to purchase satellites in a non-discriminatory way, while ensuring consistency with the space development policy. Package states that GOJ and related agencies may procure in a non-discriminatory way satellites not necessary for the autonomous development of space technology.	The effect of the statement with respect to revocation of the prohitition is unclear. Its practical effect on opening the market to actual sales opportunities for U.S. firms will depend on several factors: (1) the extent to which new purchases of communications satellites from U.S. firms are precluded in the near term in the major market segment for such satellites, NTT, by NTT's existing arrangements with domestic manufacturers. (2) the criteria the GOJ will employ in deciding whether such foreign purchases are consistent with Japan's space development program; we have asked the GOJ for clarification and elaboration of those criteria.

USTR Analysis of Government of Japan April 27, 1984 Announcement—Continued

USG request	GOJ response	Comments
TELECOMMUNICATIONS SERVICES (VANS)		
Remove restrictions on foreign participation in large scale VANS (Special Type II), and give written assurance GOJ will not impose prior approval system.	Package refers to Telecommunications Bill introduced to present Diet. Foreign equity restrictions on VANS included in pre-submission drafts are eliminated. However, Bill includes registration requirement for large-scale VANS that in effect gives Ministry of Posts and Telecommunications a prior approval over whether a firm can enter this business. Package commits GOJ to ensure simplicity and transparency of registration/notification procedures and fair competition between the new NTT and other telecommunications firms. Bill also requires a review of implementation within three years and to taking "necessary measure" on basis of that review.	Depending on implementation this could be a major step forward toward an open Japanese market in an important and potentially huge high tech services sector in which U.S. firms are highly competitive and eager to compete. However, here especially, the real value of the move as a market opening measure will depend very heavily on the extent to which bureaucratic procedure, and requirements such as registration are framed and implemented in a manner that neither impede a market entry by U.S. firms nor disadvantages the vis-a-vis Japanese competitors. The USG intends to exercise its right to consult with the GOJ regarding the implementation of the registration procedure, as well as carefully monitor the experiences of U.S. firms with them.
SOFTWARE		
Reject proposal to create a new software program rights law outside copyright.	Package states that GOJ will not submit proposal to this session of the Diet, but coordination of GOJ views on the issue will continue, while "noting the need for international harmony".	This does not resolve the software issue. The proposal has not been permanently rejected but appears to be still under deliberation.
DIRECT INVESTMENT		
(A) Japan move from a pre-clearance to a post-notification system for foreign direct investment in Japan.	(A) Package states "efforts are being made to further expendite" applications for registration of direct investment.	(A) This is not responsive to the U.S. request.

(B) Japan issue a forthright statement of investment policy that would allay concerns of many U.S. businessmen that Japan's policy is still restrictive toward foreign firms.	(B) No response in the package per se. "The Prime Minister's Remarks on the External Economic Measures" states only that "We heartily welcome direct foreign investment in Japan and will, therefore, continue to strive to set up an environment conducive to the promotion of investment".	(B) The response, while welcome as a hortatory statement, lacks provisions to specify and implement a new policy.
(C) Japan establish an investment "expediter" to deal with investment concerns about establishing in Japan.	(C) OTO to be expanded to handle investment complaints. New industrial compensation office to be established in JETRO to help investors.	(C) Effectiveness depends on GOJ commitment to open investment policy and followup implementation.
(D) Japan clarify that it only will act to block investments in its four restricted sectors and for national security reasons. It should also define the scope of its restricted sectors.	(D) No response.	
(E) Japan eliminate the "designated company" system.	(E) Japan has already submitted a bill to the Diet.	(E) Mainly a symbolic action; but significant.
(F) Japan approve proposed trust banking ventures involving U.S. banks.	(F) Japan has more recently agreed to admit United States and other foreign trust banks.	(F) Positive step.
ENERGY		
In November 1983 Japan agreed to take actions to encourage purchases of U.S. coal, to send a coal mission to the United States, and to participate in feasibility studies on joint development of Alaskan gas.	Package refers to followup measures of U.S.-Japan Energy Working Group: Organization of a coal mission to visit the United States in May and a statement that Japan is encouraging feasibility studies of resource exploitation.	Outcome of coal mission can not yet be determined. Only slight progress towards commencement of the gas feasibility study has been made.
LAWYERS		
Submit legislation this year to enable U.S. lawyers to provide advice on United States and international law.	Package states that the GOJ will work for an appropriate solution as soon as possible, while "respecting the initiative" the Japan Federation of Bar Associations is making for a solution.	The United States will request clarification on the intended timetable for action to resolve this issue.

Senator MURKOWSKI. Thank you very much, Ambassador Smith.

We will next turn to the last of the administration witnesses, the Honorable Lionel H. Olmer, Under Secretary of Commerce. And you may note, Mr. Secretary, we have switched the order of testimony but it was one of those necessities. We are glad to see you back.

STATEMENT OF HON. LIONEL H. OLMER, UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE

Mr. OLMER. Thank you, Mr. Chairman.

I am the administration spokesman at a conference on the Export Administration Act, and in fact I am required there now. What I would like to do is simply submit my statement for the record and make two very brief comments and then, with your permission, take my leave. I would be happy to respond to any questions for the record if you would like, sir.

Senator MURKOWSKI. My only observation is that the Export Administration Act has been in conference as long as I can remember. I hope that your addition will result in the successful culmination of that effort.

Mr. OLMER. Success is in the eye of the beholder. In any event, whether it is successful or not, today is the last day.

My view is that the deficit that the United States has with Japan cannot be explained by macroeconomic factors alone, nor will it be resolved by purely market adjustment mechanisms. Our growing deficit in manufactures trade is most disturbing to me and to a number of others, both in the Government and in the business community.

By 1985, it is projected to reach $45 billion.

Senator MURKOWSKI. $45 billion?

Mr. OLMER. $45 billion by 1985. That suggests to me that our areas of preeminence in the rest of the world, our areas of strongest competitiveness, are going to be severely threatened by a continuing inability to sell sufficient quantities of their goods and services into Japan. That loss of competitiveness will translate into a lack of ability to compete adequately in Third Country markets as well if they are unable to confront their Japanese competitors on Japan's home ground.

It is all the more important for the Government to remain firm in insisting upon relatively equal treatment by Japanese Government and business authorities, the kind of treatment which we traditionally have provided Japan. It seems also clear to me that the Japanese Government realizes that the time has passed when Japan can accept a lesser place in the councils of leadership in the world, and it has moved to a position of responsibility and respect.

We anticipate that that will continue and that the efforts made by the administration over the last 4 years, which have been significant, have laid the framework for achieving in practice what has been agreed to in principle.

Thank you, sir.

[Mr. Olmer's prepared statement follows:]

PREPARED STATEMENT OF HON. LIONEL H. OLMER

I am pleased to have this opportunity to testify on our bilateral trade relations with Japan. For almost four years, this Administration has worked to achieve a better balance in this relationship. Although we have made important progress in some areas, the U. S. deficit in our bilateral trade has continued to grow. To some extent, this is a barometer of remaining inequities in the underlying trade relationship, and a measure of how far we have to go. But there are other, structural causes as well. It is important that we understand the balance between these two factors.

My remarks today will address this issue by first examining the nature of the deficit itself and then by focusing on steps Japan can take to help.

Our trade imbalance with Japan is too large and getting bigger. Last year the deficit stood at $19 billion. This year it will exceed $30 billion. U.S. imports from Japan increased almost 50 percent in the first six months of this year compared to the same period in 1983. This marked increase aggravates our already difficult task of resolving trade frictions with Japan while avoiding precipitous actions born of frustration.

It is not only our bilateral deficit with Japan that is increasing. The overall U.S. mechandise deficit is at record levels. This might suggest that our imbalance with Japan as a share of our total deficit is decreasing and therefore is not that great a problem. I do not agree. Careful analysis shows that the causes of our deficit with Japan are unique. They are structural rather than cyclical. I am convinced that the problem will not be resolved by market adjustment mechanisms alone. More is needed.

There are several reasons for the rapid increase in our global deficit. The dollar is strong, making our exports more expensive and imports more price competitive. Our recovery from the recession was much stronger and earlier than other nations'. We are leading the way to world recovery and our deficit shows it. The debt problems and reduced purchasing power of developing nations is another cause.

Beginning next year, we expect the global deficit to plateau, and to begin to decline thereafter, reflecting a slowing of the U.S. economy and recovering demand in overseas markets, including some LDC's. At the same time, however, we expect our deficit with Japan to continue to grow, accounting for a rapidly growing share of the overall deficit.

Our deficit with Japan is chronic. It long preceded the strong dollar, the collapse of LDC demand, and the recent surge in U.S. imports. The strong dollar and accelerated economic growth here may have added to the problem at the margin--especially our accelerated recovery--but the trend toward large and increasing deficits with Japan is an independent problem. This is evident when we examine some historical figures.

For the last two decades we have run an uninterrupted string of growing trade deficits with Japan--across changing business cycles and fluctuating yen/dollar rates. Since late 1978, growth in U.S. imports from Japan--and the bilateral deficit--has coincided with a generally weaker yen. Yet from 1974-78, the bilateral trade deficit grew even while the yen appreciated from about 290/dollar to 210/dollar. Chart 1 graphically illustrates the contrast between fluctuating yen/dollar rates and the relatively constant expansion of the U.S. manufactures trade deficit with Japan.

In 1973, U.S. exports to Japan were $8.3 billion and imports from Japan were $9.6 billion. A decade later, exports had grown to $21.9 billion while imports shot up to $41.2 billion. The result was an increase in the deficit from $1.3 billion in 1973 to $19.3 billion in 1983. In simple terms, the cause of the growing Japan trade deficit is that our exports to that country have not grown nearly as rapidly as Japan's exports to us. (See Chart 2A)

Our forecasts for the bilateral trade deficit in 1984 and 1985 confirm an even more drastic deterioration along the historical trend. In 1984 we project a bilateral trade imbalance with Japan of $30.9 billion--far exceeding previous levels--based on a slight increase in our exports to Japan and a more than $13 billion increase in our imports from Japan. In 1985, we foresee a deficit of over $36 billion with U.S. exports to Japan of $25 billion and imports of over $61 billion--almost 50 percent higher than the 1983 level.

The trend in our key manufactures trade deficit with Japan is even more disturbing. (See Chart 2B) In 1983, this deficit was already over $30 billion, with U.S. manufactures exports to Japan of about $10 billion (about 45 percent of our total exports to Japan) and U.S. manufactures imports from Japan of over $40 billion (over 98 percent of our total imports from Japan). By 1985, the manufactures deficit with Japan is projected to exceed $45 billion or about 40 percent of our global manufactures deficit. Clearly, booming imports of manufactures from Japan are fueling the deficit. They are also putting competitive pressure on many sectors of American industry. At the same time, the inability of competitive U.S. industries to penetrate Japanese markets has meant that the constituency for fair trade rather than just free trade is growing.

This becomes clearer when we examine the principal sectors of imports from Japan and U.S. exports to Japan. (See Chart 3) On the import side, our number one deficit sector is and will remain motor vehicles and parts. In 1983, the "automotive" deficit was about $14.5 billion. We expect that figure to grow to about $17 billion in 1984 and, with or without a continuation of Japan's auto export restraints, it will grow a little more in 1985.

Yet the growth in the "automotive" deficit has been relatively modest compared to electronic-based products, including office machinery, ADP equipment and consumer electronics. In 1983, our deficit with Japan in this broad sector was about $8 billion. For this year, we expect it to almost double--to $15 billion. And in 1985, it could well top $20 billion. In fact ninety percent of the deterioration in our worldwide trade balance in electronics-based products over the last four years is accounted for by Japan.

In machine tools, our deficit with Japan in 1983 was almost $400 million and this too will grow rapidly through 1985 to roughly $750 million. Japanese market shares of key high technology machine tools are even higher than the average share of 22 percent--in some cases exceeding 50 percent.

On the export side, U.S. exports of all manufactures to Japan were $10 billion in 1983 and may grow by a couple of billion dollars through 1985. U.S. exports of energy products--Alaskan oil and coal--could add roughly $2-3 billion to our exports in the longer term, but frankly the likely contribution in the next few years, even assuming the most favorable conditions, is much more modest.

Our bilateral trade deficit with Japan is of course only a part of Japan's growing trade surplus with the world. In 1983, Japan had a global trade surplus of $31 billion and its 1984 surplus will be well over $40 billion. The Japanese Research Institute of the National Economy estimates that by 1992 the Japanese global trade surplus will exceed $90 billion. These kinds of surpluses raise serious questions about the absorptive capabilities of the world trading system and Japan's relations with other trading nations, especially in the East Asia region. Korea and Taiwan, for example, have instituted import measures designed to limit their trade deficits with Japan. For other developing countries in the region, their ability to follow the market model of development requires a large, open market for their industrialized products.

Having examined the causes, composition and likely future movement of our bilateral deficit, I would like to suggest some remedies. The only permanent solution is a Japan which is open to foreign products, services and investment. Although the macro numbers don't yet show it, we have had some successes:

- o the renewed agreement with NTT provides for significant improvements in the procurement process and access to NTT-sponsored R&D.

- o the market for manufactured tobacco imports will be substantially liberalized. Our industry views this as a significant step.

- o the Japanese Government is helping facilitate long-term supplie relationships between U.S. semiconductor producers and Japanese buyers.

- o limitations on foreign ownership of most value added networks have been avoided; foreign entry into Japanese trust banking is allowed; and the designated company system limiting foreign ownership in eleven firms has been abolished.

- o Japan is taking certain actions to internationalize the yen and liberalize its capital markets.

- o we have reached an agreement on beef and citrus as well as other agricultural quotas.

- o some tariffs of interest to us have been reduced.

Most of these are of too recent vintage to show up in our trade balance yet. But over the longer term, they point in the right direction. We need more action of this type--to solve old issues and to prevent new problems.

- o MITI is still seeking to alter the system of copyright protection for computer software. This means we will have to continue to spend substantial negotiating effort merely to maintain the status quo.

- o many promised reforms in the standards area have not been put into practice. Implementation of trade package commitments has been too slow.

- o the Japanese policy of autonomous development of satellites and launch services remains a barrier to any U.S. sales to NTT and/or other GOJ agencies into the early 1990's.

- the widespread use of single tendering by Japanese government agencies has denied us the access we negotiated under the Government Procurement Code.

- Japanese imports of products covered by depressed industries policies remain abnormally low.

- NTT's purchases from us of sophisticated telecommunications equipment are well below what we'd expected.

- new proposals for legislation to establish a comprehensive industrial policy in high technology sectors contain many features which are potentially troublesome and which have given us problems in current laws. We have sought to increase transparency of Japanese industrial policy making and to open government-sponsored programs to participation by our firms. There must be no backtracking in this area.

- there has been a substantial buildup in Japanese capacity in sectors such as semiconductors and fiber optics. Capacity far exceeds domestic demand and there is little doubt that increased export to the U.S. is envisioned.

We should not approach this task with unrealistic expectations. Even if all Japanese barriers to foreign sales and participation were removed, the United States would probably still run a deficit in our trade with Japan. Under current conditions, with the Japanese market fully open, I believe the deficit would be about $15-20 billion rather than over $30 billion. This is a much smaller number, and it therefore inherently more manageable. But more important, it is a number which includes a substantial vested interest of U.S. companies which are actively engaged in the Japanese market, companies whose Japanese sales are a significant element in their overall business structure. Few such companies exist. But they would be our best defense against protectionist measures which would limit Japanese imports and, in the process, limit our own trade potential.

If our goal is not elimination of the trade deficit, what is it we must achieve? I believe the ideal is the development of two interrelated economies in which opportunities for foreigners to do business are essentially the same as for nationals. It means transparency in policy-making and rule-making processes. It is not enough simply to remove barriers. We need positive steps.

The recent report of the Advisory Commission on U.S.-Japan Relations calls for a positive Japanese trade policy grounded in the perception that an open Japanese market is in Japan's own self interest. This fundamental change in attitude would produce the kind of organic change that foreign pressures can never achieve.

An example of what I mean is illustrated in a small way by steps Dr. Shinto has taken regarding NTT procurement. He didn't just drop barriers to foreign bidding, he actively encouraged it. He sent buying missions to the United States to seek out competitive U.S. suppliers. He conducted seminars on NTT technology to make sure American companies had some of the information about future product development available to NTT insiders. He instituted procedures to accept bids in English, in New York. I suggest that such an approach be used on a larger scale.

-Japan cannot continue to rely on export growth to stimulate its own economy. Measures to stimulate domestic demand could meet real needs of the Japanese economy and create new, open Japanese markets for imports.

-It has recently been suggested that Japan eliminate all tariffs on manufactured imports. While tariffs are no longer the most significant barrier to imports, such a step would signal an important shifting of Japanese trading patterns away from almost-autarkic predominance of raw materials and toward the kind of intra-sectoral trade which is characteristic of a developed economy.

-Japanese decision making processes still have not achieved the standard of transparency which has become the norm among developed Western economies. This kind of imbalance is unhealthy. The inability of foreign firms to obtain information about pending Japanese policies is one of the most sensitive aspects of our relationship. It would be far-sighted and statesman-like for Japan to consider measures to increase the transparency of its procedures.

In conclusion, our efforts over the past four years have scored some successes. The groundwork has been laid. Promises have been made. A framework for dialogue exists. Progress has been real--but it has not been proportionate to our negotiating effort or to the inexorable growth of the trade deficit.

This pace is unacceptable--and we know it. We are looking now for real changes and time is short. The growing bilateral deficit is a measure of how far we have to go.

CHART I

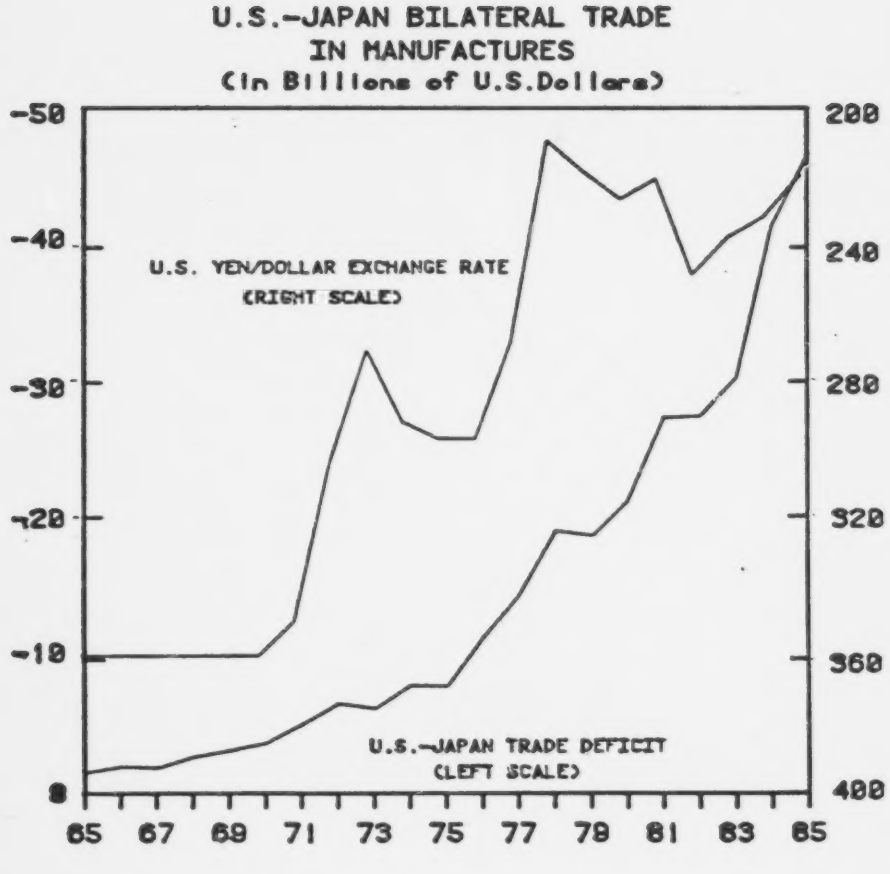

U.S.-JAPAN BILATERAL TRADE
IN MANUFACTURES
(In Billions of U.S.Dollars)
-50
-40
-30
-20
-10
0
200
240
280
320
360
400
U.S. YEN/DOLLAR EXCHANGE RATE
(RIGHT SCALE)
U.S.-JAPAN TRADE DEFICIT
(LEFT SCALE)
65
67
69
71
73
75
77
79
81
83
85

CHART 2A

U.S.-JAPAN BILATERAL TRADE FORECAST, 1980 - 1985

(Billions of Dollars, f.a.s./Customs)

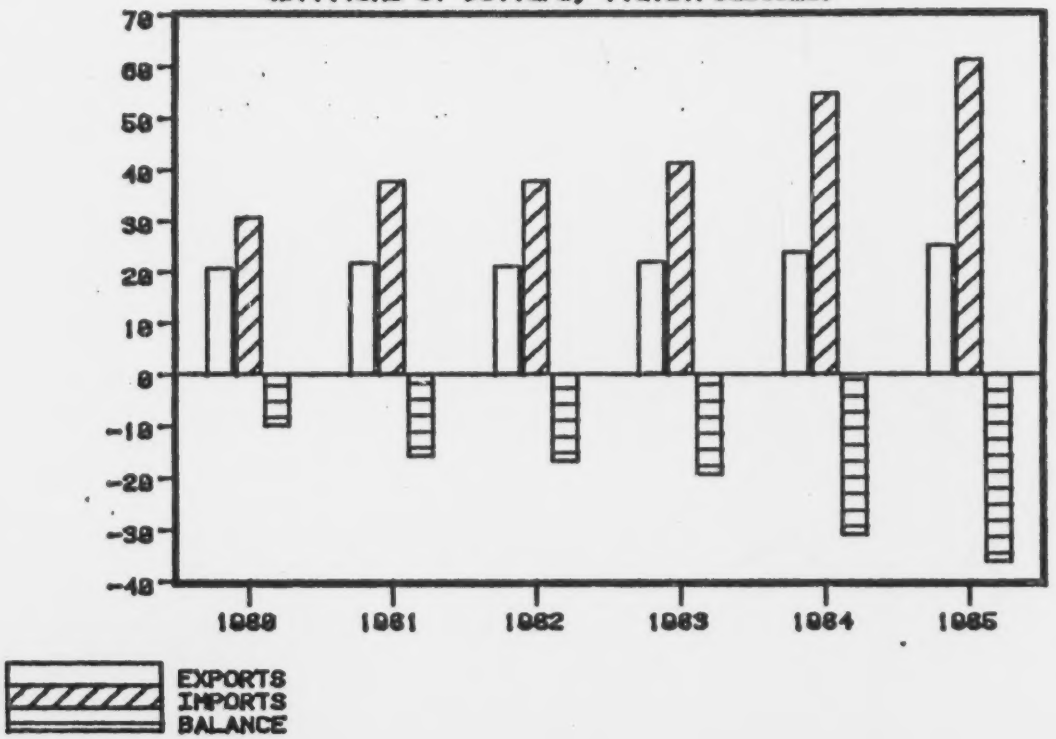


CHART 2R

U.S.-JAPAN BILATERAL TRADE FORECAST FOR MANUFACTURES, 1984 - 1985

(Billions of Dollars, f.a.s./Customs)

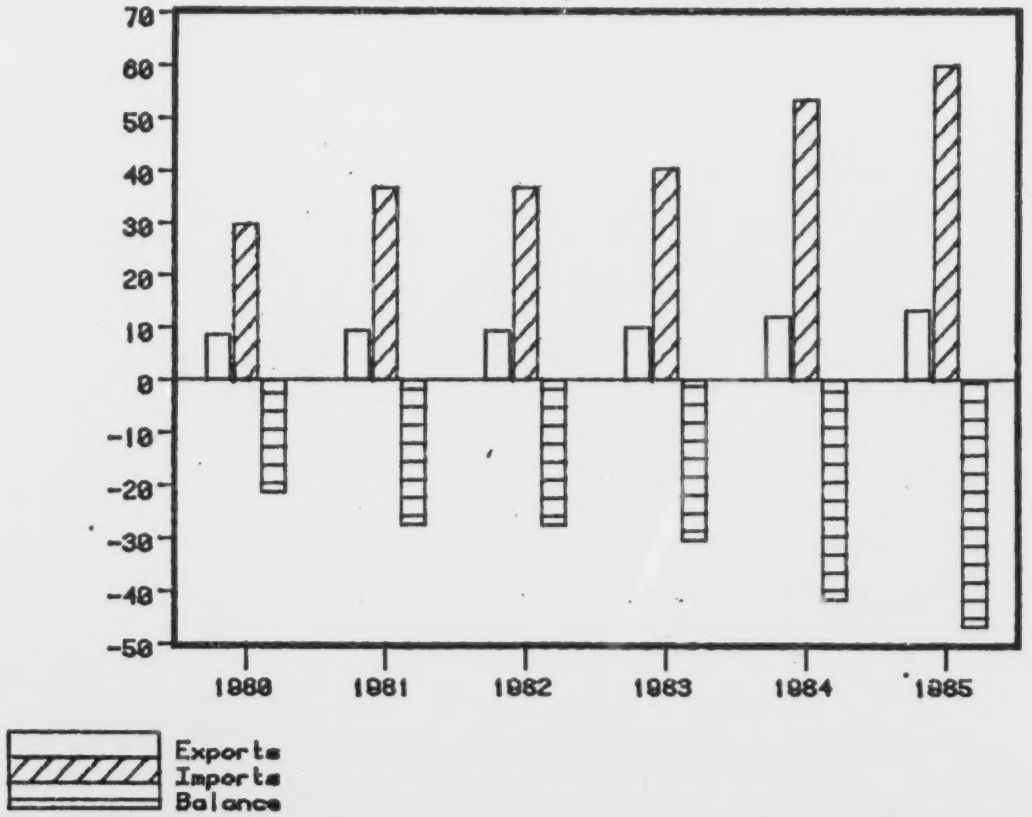
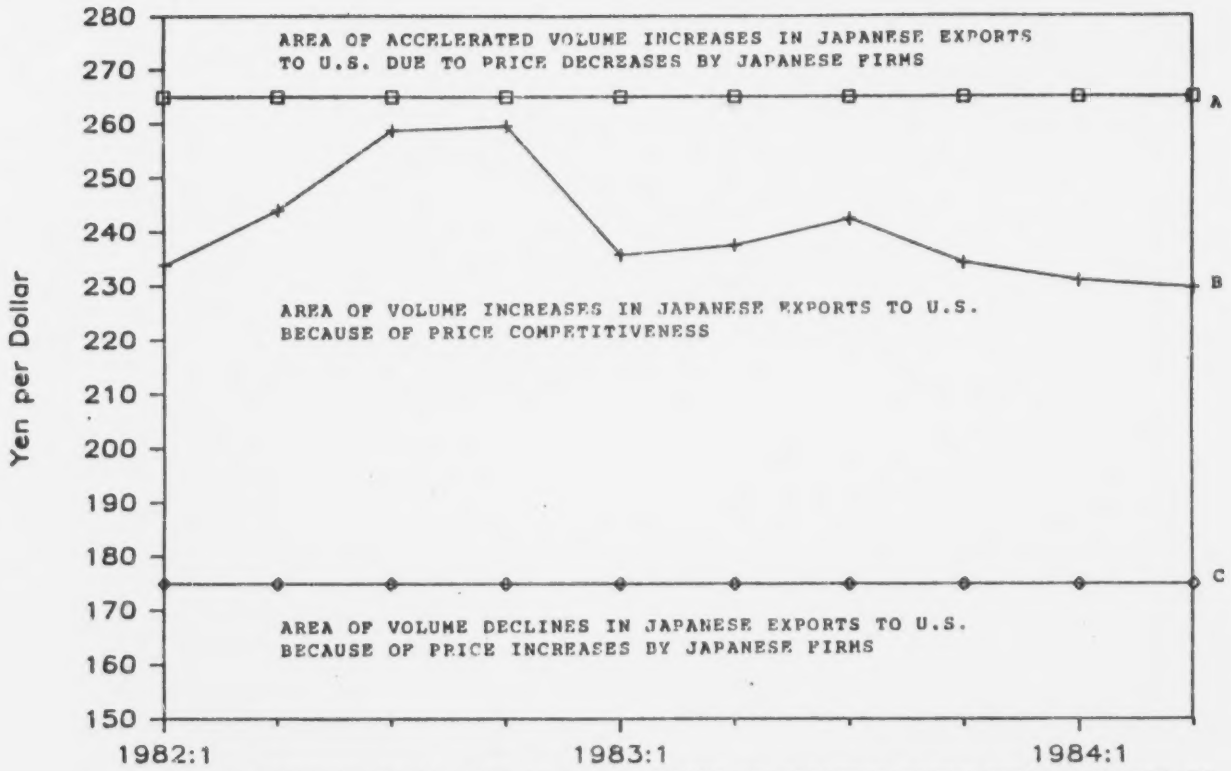


CHART 3

THE LARGEST POSITIVE AND NEGATIVE COMPONENTS
OF THE 1984 U.S. TRADE BALANCE WITH JAPAN

(January-July in Millions of Dollars)



A -- YEN/DOLLAR (¥/$) RATE AT WHICH VOLUME OF JAPANESE MANUFACTURED EXPORTS TO U.S. BEGINS TO ACCELERATE

B -- AVERAGE QUARTERLY ¥/$ EXCHANGE RATE

C -- ¥/$ RATE AT WHICH VOLUME OF JAPANESE MANUFACTURED EXPORTS TO U.S. BEGINS TO DECLINE

U.S.-Japan Bilateral Trade and Trade Balance
(in billions of U.S. dollars)

Year	U.S. Exports	U.S. Imports	Balance	Average Yen-Dollar Rate
1965	2.1	2.4	-.3	360
66	2.4	3.0	-.6	360
67	2.7	3.0	-.3	360
68	3.0	4.1	-1.1	360
69	3.5	4.9	-1.4	360
70	4.7	5.9	-1.2	360
71	4.1	7.3	-3.2	350
72	5.0	9.1	-4.1	303
73	8.3	9.6	-1.3	271
74	10.7	12.4	-1.7	292
75	9.6	11.3	-1.7	297
76	10.2	15.5	-5.3	297
77	10.5	18.6	-8.1	269
78	12.9	24.5	-11.6	210
79	17.6	26.3	-8.7	219
80	20.8	30.7	-9.9	227
81	21.8	37.6	-15.8	221
82	21.0	37.7	-16.8	249
83	21.9	41.2	-19.3	238
84I	5.7	13.0	-7.3	231
II	5.9	14.0	-8.1	230

Senator MURKOWSKI. In order to accommodate your tight time schedule, Mr. Secretary, I would like to start my questions with you. I will keep them brief. You indicated a very alarming figure in your estimate of a $45 billion trade imbalance by the end of 1985. Do you feel, as Under Secretary of Commerce we have adequately fixed accountability within our Government for this problem? Is the responsibility for that trade imbalance within your Department?

Or is it your observation that we do not necessarily have a policy of accountability to rectify the trade imbalance? We just do it on a best efforts basis. Could you enlighten the committee a little on what role the Department of Commerce should play in directing its attention to this trade imbalance?

Mr. OLMER. I hope what I am about to say is enlightening, although again that is probably in the eye or ear of the beholder.

In the first instance, Government has only a limited responsibility for what is going to represent a trade balance or imbalance. The first order of responsibility rests with the private sector, and that is as it should be. There are many things the Government can and should do to provide an environment in which business can more adequately compete in world markets. The Reagan administration is very proud of its record in that respect in targeting the process by which businessmen compete.

With respect to markets that have been, shall we say, inadequately opened to U.S. entrepreneurs, the Government has a particular responsibility to chip away at those barriers, whether they are in the form of high tariffs or in the form of nontariff barriers—which, as you well know, are harder to discern and more often even more difficult to eradicate.

Japan represents a very special problem in both respects. Japan is very pleased and usually refers to its low weighted average tariff as representing perhaps one of the lowest in the world, perhaps even better than that of the United States. But if you look at it in strictly microeconomic analytic terms, you will find that they have eliminated tariffs in such products that there is no one in the world that will compete with Japan on, such as color television sets or consumer electronics.

More to the point, I think you are driving at the question of trade reorganization, and as you know and as I believe you have been a supporter of, President Reagan did indicate support for a package of trade reorganization that would have created a Department of Trade and Industry.

My boss, Secretary Baldrige, believes and continues to believe most firmly that that is required by our Government. It is our expectation that that will be reintroduced by a second Reagan administration when a new Congress convenes in January 1985, and that we will press for it.

How much of a difference it will make to the trade deficit, well, no one can be sure. But at the very least, it would send a signal to our trading partners of our commitment to centralize and sharply focus responsibility in the Government and to make no mistake about who is responsible for what across the board, and I think that is a good thing.

Senator MURKOWSKI. So your implication is that currently there is not necessarily a clearly defined area of responsibility as to which department is accountable for the negotiations that must dictate a response to the trade imbalance?

Mr. OLMER. That is a broad question, but I would agree with you, with some qualifications.

Senator MURKOWSKI. You feel that your Department has the responsibility of a MITI in working with the private sector to develop policies?

Mr. OLMER. Well, it does not now have that ability, because it lacks the authority. The authority is not only shared—and a large measure of sharing is necessary—but it is disaggregated, disaggregated in terms of enforcement and pursuit of trade remedies, that split between an agency and a department of Government, and I happen to believe that there should be a consolidation of that.

Trade policy and trade negotiation is clearly the responsibility of the U.S. Trade Representative. However, there are areas in which the Commerce Department has played more than a tangential role in the formulation of trade policy, and it seems to me that an improvement in that respect could be made as well.

Senator MURKOWSKI. We have seen this imbalance grow. I think last year it was $19 to $21 billion, depending upon what analysis is used. I think through the first 6 months of this year it was in excess of $17 billion, so it is obviously going to increase beyond $30 billion at the end of the year, and you have projected $45 billion for next year.

Mr. OLMER. I am projecting $45 billion in manufactures trade. A former Deputy U.S. Trade Representative once said that, with respect to Japan, the United States is rapidly becoming a developing country. We ship agricultural products and raw materials and the Japanese ship us manufactures.

That trend is an alarming one, and it has been sustained over a number of years, and that trend in my view must be reversed. I am not arguing that it is right and proper that there be a zero trade balance; that is, neither side have a surplus or a deficit, obviously not. We could clearly sustain without great difficulty a trade deficit with the Japanese. We could sustain it and still make plain to our business community that that nonetheless represents free trade.

We cannot do that right now because I do not think we have the kind of equilibrium that would justify an endorsement.

Senator MURKOWSKI. Enlighten me a little bit on equilibrium. Are you implying that you do not have within your Department the authority to control this imbalance?

Mr. OLMER. We never would and never should, and no one in Government should.

Senator MURKOWSKI. Well then, relative to your impression of "should," the question is, the private sector depends upon Government to negotiate the policies of trade between nations. Now, how do you correlate that with the imbalance that we have seen develop and expand, in the sense of accountability of an appropriate Government agency to reflect on that imbalance?

Mr. OLMER. Senator, if the question is, if the Commerce Department had all of the authority it ever dreamt it would want—and that is a lot——

[Laughter.]

Mr. OLMER [continuing]. Would our relationship with Japan be significantly different, the answer is probably not. We have in our administration now as aggressive, knowledgeable group of people committed to the same objectives as we are ever likely to have. We have made marked improvements by virtue of the efforts of the Agriculture Department, the Commerce Department, the State Department, the U.S. Trade Representative's Office.

Without any doubt in my mind whatsoever, the stage is set for Japan to take some initiatives at an increasing rate and to implement the promises which have been made. If they do that, we will see that deficit shrink somewhat.

Senator MURKOWSKI. Let us assume that Japan does not initiate the necessary steps. I do not know whether it would be useful to try to assess how fast that can occur. But the point is, the trade deficit is broadening, and you have indicated that you do not see it as a responsibility necessarily of Government. You imply that it is a responsibility of the private sector.

The frustration, of course, in the legislative body that I serve in is perhaps a little more direct, and it relates specifically to a tremendous concern over the imbalance. Frustration is growing. There is one answer that is obvious to all of us, and that is protectionism, which is certainly something I do not support.

Other alternatives appear to include a decision made by the Japanese as to whether or not they wish to offset the deficit by purchasing more from the United States. The frustration is one that we share, but with your prediction of where this imbalance is going, and one can only relate to the immediate timeframe, I fail to see anything significant on the horizon.

We saw a summit meeting between President Reagan and Prime Minister Nakasone. We saw the formation of various study groups. That was November 1983. What in your view is occurring that would indicate that Japan is being responsive to and responsible about our growing concern over the expanding deficit in the balance of trade?

Mr. OLMER. I believe Ambassador Smith itemized some. A number of similar undertakings have been mentioned in my testimony as well.

Senator MURKOWSKI. But even though those are meritorious, the gap still widens.

Mr. OLMER. I would return to the point I made earlier. That is, that the stage has been set, the Japanese have announced certain undertakings and have made efforts to put into practice those undertakings. It is too soon to see that effort reflected in the trade statistics, but it is my hope and expectation that with sustained attention by Government officials on our side and a sustained commitment by Japanese Government officials, we will begin in 1985 to see a reversal of that alarming trend.

Our projections are based upon the status quo and do not contemplate any efforts at implementation. More could be done. More could be done if, for example, the Congress were to permit the export of Alaskan crude oil to Japan. More could be done if Japanese economic planning stimulated domestic spending and thereby increased Japanese domestic demand.

More could be done in a number of other respects that are itemized in the testimony of Under Secretary Wallis and Ambassador Smith, as well as my own. We do have to keep pressing and we will.

Senator MURKOWSKI. I will excuse you, although I cannot do so without taking the opportunity to ask you if the administration is prepared to recommend the sale of a portion of the excess Alaskan crude oil; that is, excess to west coast, to ask the Congress of the United States to lift the ban?

Mr. OLMER. We do not now have a position on that, to my knowledge. I would defer to the chairman of our Interagency Energy Working Group to respond to that question.

Mr. WALLIS. I think we have a position that we are in favor of the export.

Senator MURKOWSKI. Are you prepared to recommend it during the next session of the Congress?

Mr. WALLIS. Whether we recommend it to Congress is a complicated question about how things stand in Congress. We have discussed that with you.

Senator MURKOWSKI. That will always be complicated.

Mr. WALLIS. We discussed that. When we see an appropriate opportunity, we certainly will seize it.

Senator MURKOWSKI. I want to thank you, Mr. Secretary, for your testimony. If the other witnesses can bear with me for a few more questions, we can excuse you. You are welcome to stay at the table if you care to and if you do have a few more minutes. I personally feel that we have a great accountability problem within the U.S. Government, because I do not think trade policy is a responsibility fixed within the Department of Commerce, the Department of State or the U.S. Trade Representative.

And I look with envy at the efficiency in Japan of MITI, which under no uncertain terms will dictate that portion of the market that is available to an American or a foreign firm coming into Japan and under what terms they will come in. It is an ideal and efficient blending of the process which I think is reflected in the tremendous economic recovery which Japan has experienced in their position as a world economic power.

Our broad democratic traditions probably do not develop those types of efficiencies, but I think that a $45 billion trade deficit, Mr. Secretary, while progress is being made, is in itself certainly an attention getter. And I think it would spur some very positive, concrete evidence of Japan's willingness to be responsive.

We have seen what some of our other neighbors in the Pacific have done. We have seen Taiwan come into the United States with procurement missions to do something very positive. There is certainly a difference, and not necessarily a comparison, but from the standpoint of public consumption I think that there is a message that has been delivered in the attitude and good faith of the Taiwan people toward this problem.

But there again, I would like to defer now to the other witnesses. Ambassador Smith, you mentioned the point of equal treatment and, recognizing the limitation of time, I wonder if you would expand a little more and give us your assessment of where we are with regard to equal treatment. And that means to me the ability

of our manufacturers, of agricultural products, to have equal access in Japan, as opposed to access limited by Government intervention.

Mr. SMITH. Yes, sir. The question of equal access, equal opportunity to compete, is in our view the nub of the problem. You have, if you will, nominal equal access. That is to say, something which is in comformity with the written rule, if you will, of the General Agreement on Tariffs and Trade or any other international undertakings that you have. And then you have the practical application or implementation of those principles.

I think it has been generally felt that on the latter score the terms have not been equal; the opportunity to compete in Japan has not been the same as has been afforded in this country to other foreign competitors, including Japan.

Perhaps the most celebrated example of that was with the baseball bat case and the question of standards and certification. Hopefully, that issue is behind us, although, while the Japanese Diet has passed 16 laws which have changed the current procedures, there is no question as well that those procedures were discriminatory in their procedural aspects; that by the changing of these procedures we think that access has been improved for some 60 percent of all of our manufactured exports across a wide variety of sectors.

But whether you talk about standards and certification or, let us say, NTT procurement, to get access on generally equal terms as afforded the Japanese producers in Japan, the jury is still out on that. As Under Secretary Olmer has said, we have made progress. It is too early to make an assessment as to whether the commitments and undertakings by Japan will bear fruit in the sense of a concrete dollars and cents or yen trade between our two countries.

The problem is both, as I say, a theoretical one—there have not been too many instances, for example, where Japan has been found to be acting in violation of GATT provisions, for example. And I would not want to make such a statement, but again, as Under Secretary Olmer said, their tariff rates generally tend to be very low, and yet we still have difficulty in getting into that market.

We think it is a question that there are ways that, in earlier times at least, foreign suppliers were in one form or another discriminated against. I think that they are. The Japanese are very aware of our concerns on this, and nowhere has this been perhaps better illustrated than on the question of telecommunications and the value added network systems, which is an area of potentially billions of dollars for us and in which we have had the fullest cooperation in the last 6 to 12 months as the Japanese amend their laws that the implementation regulations are done in such a way so as not to discriminate against foreign, potential foreign suppliers.

It is that sort of thing, not easily quantifiable like a tariff matter, but nonetheless all-important in the administration of trade, the trade provisions, that we are concerned about, sir.

Senator MURKOWSKI. Is it fair to say that from your particular area of responsibility you feel there is an inadequate and unresponsive effort currently to attempt to equalize treatment on some schedule that will take you from here to there?

Mr. SMITH. Yes. I would say that in some cases the responses are not what we think we should have or need to compete on equal terms.

Senator MURKOWSKI. Assuming that is the point, then what do you do at that point where you do not feel that there has been an adequate response? Do you go back again or do you have some other avenue available to you in your responsibility to go on and try and——

Mr. SMITH. Well, we obviously try to engage in detailed, concerted discussions with them to try to get some, if you will, concessions on a product or an issue between us. And this is across the government we do this. If not, we have taken the Japanese to the GATT, for example, on the leather case, and we now expect that the Japanese will bring their import practices regarding leather into conformity with the GATT decision. That is their solemn obligation as a signatory to the GATT.

So we hope to work these out bilaterally and not have to get into a dispute settlement mechanism, as is foreseen in the GATT. But we are prepared to do so.

Senator MURKOWSKI. Well, our concern, of course, in the Congress of the United States is a change in the trend, and the trend is a growing trade imbalance.

Let me ask either one of you gentlemen, do you feel that it is appropriate that some type of congressional action be taken? And there is a broad area open to the Congress to become involved, but by the Constitution the matter of trade policies are set through the various agencies of the administration.

But by the same token, if the agencies do not have the necessary tools to work with, because it takes two sides to negotiate, to be responsive to a trade imbalance—there has to be a willingness. If it is not there, then it begins to catch the eye of Congress as to what should be done about it.

And as I mentioned with Secretary Olmer, one way is to pursue protectionism, but that is certainly not in the best interest, in my opinion, of our country. But at some point in time, it is appropriate to expect a response from Congress over of the frustration of the growing deficit.

What do we do, gentlemen? You have negotiated in good faith. You have made progress, but the proof is in the pudding and it is going the wrong way.

Mr. WALLIS. If I could comment on that. First, there are some things that Congress can do. You alluded to one earlier yourself. I guess Secretary Olmer brought it up first. If we would allow the export of Alaskan oil, that would be to the great economic advantage of the United States in terms of energy cost and efficiency, and it would also result in a very substantial change in the bilateral balance of trade between us and Japan. That could knock a very major chunk out of it, depending upon how much oil we allow to go there.

There are similar things in the coal area. There are laws in this country that make the cost of shipping coal to Japan higher than it ought to be. Congress has declined to pass the laws that would enable the construction of slurry pipelines that would lower the cost of shipping coal.

There are probably other things of that sort, where there are laws in this country that add cost unnecessarily to products that we otherwise might be able to sell to Japan or where, as in the extreme case of the oil, we actually prohibit it. I think there are one or two other commodities that are prohibited, like horses.

Senator MURKOWSKI. Let me ask you this: Why, in your opinion, if Japan is being responsive to the trade imbalance, is Japan buying less coal this year from the United States and more from Canada?

Mr. WALLIS. Well, from Canada they have a long-term contract.

Senator MURKOWSKI. Well, they do not have long-term contracts with the United States. We seem to fill the gap or the swing, instead of being able to negotiate. And yet the thing that frustrates me is we are Japan's largest customer. So obviously the relationship is most beneficial to Japan, and if they see a deterioration in our relationship as a consequence of the growing trade imbalance and then look at the figures relative to something that Japan is dependent on, the importation of energy, and yet they respond by buying less each year as opposed to more, one can only come to the conclusion that they are not being responsive to the imbalance that is growing.

Mr. WALLIS. I do not come to that conclusion in that case.

Senator MURKOWSKI. Well, I would appreciate some enlightenment, then, because that is the conclusion I come to.

Mr. WALLIS. Like us, they are predominantly operated by private enterprise and they buy where they get the best deal.

Senator MURKOWSKI. But when you have a business relationship, you also take care of your best customers.

Mr. WALLIS. The people that buy the coal are not the same people that sell the transistors and what-not, as is the case in this country.

Senator MURKOWSKI. That is true, but that is the clearinghouse role of government. It is the responsibility for accountability of trade policy, and I think we have agreed that in general terms we do not have accountability in any one agency for uniformity of trade policy. We have agreed that there may be a better way to do it, and that may require some legislative changes.

Mr. WALLIS. We do not have a collectivistic economy here, so the Government does not do that kind of trading off between agencies. But let me mention something along this general line, the $45 billion figure that Lionel Olmer mentioned. I have been a statistician for most of my career and I do not take any stock in figures like that. I would be tempted to say I will believe that after I see it, but I will not believe it then, either.

If you look at the international trade figures, you find, for example, that the figure given as statistical discrepancy in the total world figure is about equal to the figure given for the U.S. deficit. I am not suggesting that the whole U.S. deficit is illusory or all wrapped up in that statistical discrepancy, but I am suggesting that a very large part of it may be, not with Japan specifically, but in the worldwide balance.

And I want to make the point that it is the worldwide balance that counts and not the balance of any particular country. With Japan, it was mentioned that we are one of the major manufactur-

ing economies in the world and so we might expect to sell a lot of manufactured products to Japan. We are also the major agricultural economy in the world, and in general you will find that where we are trading with a country that does a lot of manufacturing what we sell them is mainly agricultural, and when we are dealing with a country that is mainly agricultural what we sell them is mainly manufacturing.

Consequently, the imbalance with Japan on manufactured products alone is not significant. They are our biggest customer for agricultural products.

What we have to look at is the aggregate. Japan is definitely protectionist and there is no question that we would be better off if they were not. On the other hand, if they are protectionist, we would be even worse off if we became protectionist.

Senator MURKOWSKI. I could not agree with you more.

Mr. WALLIS. In Japan, it would be greatly to Japan's interest to be less protectionist, for the same reasons you are giving why it is to our interest to stay nonprotectionist. And gradually that seems to be dawning ~~on~~ them. All the top policymakers, I think, understand that.

However, being a democracy, they have political considerations, such as we do. That oranges and beef negotiation was fascinating from that point of view.

Senator MURKOWSKI. How much are we talking about in oranges and beef if the restrictions were totally removed?

Mr. WALLIS. I do not know what the aggregate would be.

Senator MURKOWSKI. I heard it was somewhere between $500 million and $1 billion over 5 years.

Mr. WALLIS. Well, the more years you take the bigger the number will be.

Senator MURKOWSKI. I know, but when you take $500 million to $1 billion, if they were to remove restrictions, and deduct that from the total trade imbalance, it is a pretty insignificant figure.

Mr. WALLIS. I think the example illustrates, however, how the protectionist pressures work and what we have to work against to get them to move, and we did get them to move on that.

Senator MURKOWSKI. Mr. Secretary, do we have a plan within our administration to achieve substantial relief from the trade imbalance, set out clearly over a period of time with a defined procedure, that we have presented to the Japanese? And if so, have they responded and met the plan and the time schedule and so forth?

Mr. WALLIS. The trade imbalance with Japan specifically is not in itself a primary objective. It is the ability to sell everything there that we ought to be able to sell that is important to us, and we do have——

Senator MURKOWSKI. We would achieve a good deal of satisfaction if you accomplish the former, because the latter takes care of itself.

Mr. WALLIS. As Secretary Olmer said, there are a lot of reasons why we can expect not to have a balance of trade with Japan specifically.

Senator MURKOWSKI. I understand that.

Mr. WALLIS. But our plan is to keep trying to persuade them that it is in their interest to reduce their protectionist barriers. And we

work on it. It is the USTR that carries the ball in doing the work, by taking one particular case after another.

And there is a strong recognition among top leadership in Japan that they should do this. Prime Minister Suzuki criticized Japan for being too protectionist and said they have to get a different orientation and a different point of view. Prime Minister Nakasone has been even stronger in that direction and has made some major moves. But we have a long way to go.

Our plan is to keep working away at them.

Senator MURKOWSKI. Do we have a systematic plan that we have presented and asked them to respond as to how they would address reducing substantially this problem?

Mr. WALLIS. I would say it is systematic. We take the major obstacles, and we grind away on those.

Senator MURKOWSKI. Let me refer to the last public display of the effort in a meeting with our President and Premier Nakasone, where there were detailed conversations about what can be done about the imbalance or what we can do to encourage Japan to buy more from us. They went into the energy areas and there was a study group which you had an association with, certainly, directed to coal, gas, and other forms of energy.

And it is my understanding that since January 1983 the only thing of substance that has come from those meetings is a commitment by the Japanese to enter into a prefeasibility study. Now, that is new terminology to me. I know what a feasibility study is, but a prefeasibility study is like having another alternative.

But that is all that has been accomplished.

Mr. WALLIS. Not quite.

Senator MURKOWSKI. I would appreciate knowing something other than that that would be substantive, that would address the problem of how you get there from here.

Mr. WALLIS. For example, before those meetings their rate of purchase of coal was falling very rapidly, and the predictions were that it would be about half this year what it had been last year; and last year it was way down. After those consultations, the drop stopped, and we are hoping that with the recovery it will pick up. But at any rate, there was a dramatic cessation in the decline.

On the gas, again there is a question of whether it is economical to ship gas from Prudhoe Bay to Japan, and the way they got into the prefeasibility study is that a feasibility study in that case is so enormously expensive that they wanted to do a preliminary look to see if it is worth making a feasibility study. And as you know, some of the owners of Prudhoe Bay gas think it is not worth making even a prefeasibility study.

Senator MURKOWSKI. It is my understanding the prefeasibility study is related to a coal project.

Mr. WALLIS. Well, there is one on the gas project, which is vastly more important if it were to come off.

Senator MURKOWSKI. It is certainly no secret that Japan is energy dependent and buys energy from all over the world. They buy very little from North America. There are no long-term commitments that I am aware of that have been initiated.

Mr. WALLIS. There is one in Alaska. They have been buying natural gas for about 20 years from the Cook Inlet, about a billion tons a year—or a million tons a year.

Senator MURKOWSKI. I am talking about anything new. The point is, if you are going to seriously do something about the trade imbalance, you are going to have to look at some big ticket items, and it would appear that energy would be an appropriate one.

And I know that efforts have been made, but again it is a question of how long is it going to take, particularly when the imbalance is going the wrong way.

And I think, Ambassador, you had a comment that you wished to make?

Mr. SMITH. Yes, sir. You asked, do we have a plan or a strategy? Our plan has been, sir, to address those elements which contribute to the trade imbalance, in which we do not feel we have had an opportunity for equal access. Our tactic has not been to address the trade imbalance for addressing the trade imbalance's sake, if you will.

It is, rather, to enhance the opportunity of American businessmen and entrepreneurs to sell in the Japanese market. Part of this is the anticipation of problems, such as telecommunications, satellites, or, most pressingly now, the question of computer software. Part of it is obviously to redress past practices such as the Japanese tobacco and salt monopoly.

Some of it is residual in terms of tariffs, where we have been pressing on specific line by line items for tariff relief, where we think either the Japanese tariff barrier is too high or that there are tariffs which create unnecessary obstacles for us to compete, such as in forestry products, where both the United States and Canada have a natural and comparative advantage.

So we do have a strategy or a plan which is focused on the principle of trying to get at areas of access, and not just to redress it in the sense of trying to redress it for redressing's sake.

Senator MURKOWSKI. How long have you had this plan?

Mr. SMITH. We have had it for years.

Senator MURKOWSKI. And how is it working?

Mr. SMITH. As I said, I think we have had good news and we have had bad news. We have made progress on some issues.

Senator MURKOWSKI. Are you satisfied with the progress?

Mr. SMITH. No, sir.

Senator MURKOWSKI. I want to thank you gentlemen for taking the time and altering your schedules to accommodate us. I know that you are under a time constraint. I think that as a consequence of your testimony—incidentally, I want to advise you that all of your written statements will be included in the record—we have highlighted, certainly, some of the problems associated with the alarming increase in the trade deficit.

Might I ask you, is there any immediate proposal in the sense of a scheduled meeting to address currently this problem at the appropriate diplomatic level?

Mr. WALLIS. Do you mean the problem of the bilateral balance?

Senator MURKOWSKI. The problems we have discussed here, whether it be accessibility, whether it be marketing more or reducing the trade imbalance. Is there a specific schedule of meetings?

Mr. WALLIS. Yes; twice a year we have bilateral comprehensive economic consultations with the Japanese. We had such meetings just the week before last. Anything can be on the agenda there and trade issues are usually dominant.

And I might say, in terms of those meetings, they are very useful, and one of the most useful parts is the side contacts. Often, very specific, concrete issues are negotiated man-to-man on the side, where people explore what could possibly be done that would make progress, and then in the formal meeting maybe progress occurs.

One of those meetings was just held. Another one will be held in about 6 months.

Mr. SMITH. Mr. Chairman, from the USTR side, we are engaged in almost constant meetings with our Japanese colleagues. We have met, for example, last week on the west coast on forestry. This week we will be meeting with representatives of the NTT regarding the agreement and how it is being carried out and the first year of the new agreement.

These meetings go on, sir, on a continual basis.

Senator MURKOWSKI. I can only observe, gentlemen, perhaps that is not enough, because certainly you, Mr. Ambassador, share some frustration in the sense that we are not able to penetrate the Japanese markets adequately. I think, Secretary Wallis, you have indicated that you feel optimistic because progress is being made.

But as long as that trade deficit is increasing, I assure you that the attitude of Congress will be one of frustration and an interpretation of unresponsiveness from our friends the Japanese. And I guess the balance of the hearing will enlighten us a little further on some of these frustrations.

I can only assume that you gentlemen share my observation that we do not have within the system of the agencies responsible for trade accountability for trade policy in the sense of being able to lay on one of your specific doorsteps the tools necessary to address the deficit and an ability to make an appropriate response.

I share your collective observations that everybody has a role, but the question of accountability is not defined because we have never had the necessity, perhaps, of doing it.

Mr. Ambassador, did you have another comment?

Mr. SMITH. I am not 100 percent certain, Senator, that I would share all of that. I think it depends how you call what you mean by an accountability.

Senator MURKOWSKI. Somebody to talk to who has responsibility for allowing a $30 billion-plus trade deficit to occur.

Mr. SMITH. Again I would come back to the point, I think even Under Secretary Olmer made the point, is it the responsibility of the Government to allow or disallow an imbalance in trade? I think the question is, is there mechanisms within the U.S. Government which work to help American exporters get access? And there I would say, yes, there are mechanisms.

Senator MURKOWSKI. I have no disagreement with that.

Thank you very much, gentlemen. We do appreciate your attendance this morning.

Mr. WALLIS. Thank you.

Mr. SMITH. Thank you, sir.

[Pause.]

Senator MURKOWSKI. We will resume the hearing and call to the witness stand panel two: Mr. Nathaniel Thayer, Johns Hopkins University School of Advanced International Studies; Mr. Hugh T. Patrick, R.D. Calkins professor of international business, Columbia University; Mr. Mike Mochizuki, assistant professor of political science, Yale University. And Mike, I want to apologize for mispronouncing your name.

I do welcome you to the committee and look forward to your testimony. We will start, I believe, with our first witness, which on my list is Mr. Nathaniel Thayer. We welcome you to the committee, Mr. Thayer, and look forward to your testimony.

STATEMENT OF NATHANIEL B. THAYER, DIRECTOR OF ASIAN STUDIES, JOHNS HOPKINS UNIVERSITY SCHOOL OF ADVANCED INTERNATIONAL STUDIES, WASHINGTON, DC

Mr. THAYER. Thank you, Senator.

I would like to talk this morning about the near-term prospects for economic relations between Japan and the United States. Are the two nations starting to build a historic rivalry, or are the two nations, with a certain amount of jockeying, coming together to form an alliance that will set the pace and style for international economic life?

The answer is not easily arrived at. Let me first offer the evidence that suggests that economic relations with Japan will be a lot better than they have been. I ask you to think back less than 2 years ago to the state of Japanese-American relations then. In December 1983, Ambassador Mansfield said:

> Our ability to manage the crisis of worldwide recession and unemployment in a manner consistent with the principles of free trade and mutual cooperation upon which our prosperity has depended for the last 35 years is at stake.

That stark sentence does not describe today's more confident mood. What has changed? Both the United States and the Japanese economies have turned upward, and that helped. But the challenge Ambassador Mansfield addressed was not the economic conditions themselves, but rather the ability to respond to them.

In short, the challenge is political, not economic. What changed? Japan acquired a new Prime Minister, and he and President Ronald Reagan hit it off.

That friendship has permitted Prime Minister Nakasone to take dramatic steps that he would not have been able to take otherwise. That friendship brought President Reagan to rein in a bureaucracy that was creating more problems with Japan than it was resolving.

What will happen in the future? I leave it to others to explain who will win the U.S. Presidential election. Prime Minister Nakasone, too, must stand for reelection this autumn, November 21 to be exact, and he is running for the Liberal Democratic Party presidency, which in reality is the election for the prime minister.

It already seems clear that Prime Minister Nakasone will handily win this election. But what will happen 2 years hence, in November 1986, when the party rules say that Nakasone must step down? The Japanese public is both quick to judge and to judge harshly its political leaders. A common pattern for a prime minis-

ter is to reach his greatest popularity shortly after entering office and then go into decline, eventually to be replaced. How long does the process take? About 2 years usually. Japan has had six prime ministers over the past 12 years.

Although Nakasone has already defied this process and gained in popularity, most commentators assume he will burn himself out in the next 2 years and the public will welcome his replacement.

I do not share this view. I believe that Nakasone has just gotten his sea legs, and at the end of 2 more years he will be even more popular and his policies will be even more broadly accepted than they are today.

It is possible to argue that the economic difficulties that we have been having with the Japanese do not have economic origins. Rather, the issue is fairness: The Japanese have violated the American sense of equity. Leaning upon the liberal world order to support their reconstruction, the Japanese now refuse to support this international order, even though they have achieved major power status. That refusal extends even to relying upon other nations to defend it. Japan, in short, still wants a free ride.

Nakasone has put an end to the free ride. At least Americans have stopped talking about it. Recognizing the linkage between equity and economics, and for other reasons, Nakasone launched Japan on an active diplomacy, encompassing nations around the world, but concentrating on the nations within East Asia.

Is it possible that this diplomacy may be too active? In studying American diplomacy in East Asia, many scholars have discovered a constant: The United States is always opposed to any nation that has attempted to establish dominancy in the region. Except for the city states of Hong Kong and Singapore and the island of Taiwan, the Japanese economic presence in the East Asian nations is greater than that of the United States.

Will we oppose Japan, then? I think not. Japan and the U.S. goal in East Asia are close, if not identical. The Japanese are not trying to shut out the U.S. interests, and the other East Asian nations exhibit some disquiet about Japan, but not to the extent of limiting Japan's purchases and investments.

A third reason that economic relations with Japan will improve is that Americans now know a great deal more about Japan and are beginning to exploit this knowledge for commercial gain. In short, Americans have turned bullish over their ability to compete.

Other evidence suggests that economic relations between Japan and the United States will continue to be contentious. The United States has a large and growing trade imbalance with Japan. The magnitude of this imbalance is unprecedented and any unprecedented problem usually invites an unprecedented solution.

Every year, the economic planning agency [EPA] in Japan prepares an economic white paper. This is the government's most important economic document. This year's white paper said that the trade imbalance in Japan's favor was "structural," meaning that it would continue to be in Japan's favor for many years. The EPA offered and the Japanese Cabinet accepted the recommendation that Japan become a major capital exporting nation.

This decision is profound and it may become the significant event historians use to mark Japan's emergence as a major power.

Certainly, Japan's foreign outlook and foreign policy will change as Japan becomes more and more directly involved in the economies of other nations.

But investment is not enough. Japan would be well advised to search out new commodities which it can purchase from the United States. The only commodities that stand any chance of significantly redressing the bilateral trade imbalance are natural resources—coal, oil, natural gas, hardrock minerals, timber, and fish.

The greatest exacerbation to the smooth functioning of economic relations between Japan and the United States stems from the type of diplomacy the two nations practice with each other. For at least the past decade, perhaps longer, the tendency has been for each Japanese ministry and for each U.S. department to practice its own diplomacy.

Each department and ministry usually sends its own men overseas. In the case of the United States, these officials find desks in the American Embassy in Tokyo, nominally under ambassadorial control. In the case of Japan, Government officials can be found both within the Embassy and outside. Along the U.S. eastern seaboard, for example, MITI has posted some 30-odd officials in various trade associations and other offices. The Ministry of Finance has 16 officers externally posted. In the U.S. case, negotiators fly from Washington to Tokyo. The Japanese make less use of negotiators originating in Tokyo.

What is wrong with everybody doing his own thing?

Many problems fall within the purview of several agencies. Agencies compete to become the responsible agency. In the United States, the agency that takes the hardest line or can prove itself most aggrieved becomes the responsible agency. In Japan's case, even though an agency fails to win primary jurisdiction, it conducts its own diplomacy anyway.

There is competition among the U.S. departments to have their problems receive top-level attention, top-level attention at the White House. Often this competition takes the form of making a problem seem much more important than it is.

There is no way to establish priorities except through interdepartmental negotiation. If everybody tries to conduct their own diplomacy, planning becomes impossible. Under this multiheaded diplomacy, the public and to a lesser extent the Congress and the White House find it difficult to discover what is really going on, since nobody really knows.

Recently, President Reagan said that the State Department will be the prime department for managing foreign affairs. Prime Minister Nakasone has made clear in his writings that he too appreciates and intends to follow classical diplomatic practice. Perhaps traditional diplomacy is to be given another chance. But still remaining strong and virulent are the reasons that broke up classical diplomacy: the growing complexity of the problems and the desire of specialists to negotiate their own affairs.

Study, then, of the practice of diplomacy is called for, since diplomacy itself can create problems as well as resolve them.

Several years have passed since the United States set up a foreign commercial service run by the Department of Commerce. Has

the time come to see how it has bettered the conduct of American diplomacy?

No further study is necessary to conclude that the United States economic diplomacy toward Japan has suffered from the deterioration of quality in our Japanese language officers. Language officers are ranked in speaking and reading ability from 1 to 5, with 3 being the minimum necessary to perform a job designated for a language officer and with 4 in both speaking and reading being the desirable level for professional competence.

Of the 151 Foreign Service officers on the Japanese language list, only 9 are ranked 4 or above. All are political officers. In the last decade, only one FSO has become a 4 as a result of Foreign Service training. All others have acquired a Japanese language ability before entering the Foreign Service.

Only one of the top four slots in the economic section in the American Embassy in Tokyo is designated for a language officer.

Although extra pay is now given for acquiring proficiency in the Japanese language, few officers want to do so. It takes too long to acquire any competence. It precludes them from getting the broad experience necessary to be promoted to the senior ranks.

Last year, only one Japanese speaking FSO was promoted to the senior ranks; this year, none. Meanwhile, three Japanese language officers retired, since they knew that they would be selected out for being in grade too long without a promotion. Several more Japanese language officers can be expected to retire for the same reason in the next or in the following year.

Thank you.

[Mr. Thayer's prepared statement follows:]

PREPARED STATEMENT OF NATHANIEL B. THAYER

What are the prospects for economic relations between Japan and the United States? Are the two nations starting to build a historic rivalry? Or are the two nations, with a certain amount of jockeying, coming together to form an alliance that will set the pace and style for international economic life? The answer is not easily arrived at.

Right now everything seems quite fine. But we are just before a Presidential election. Certainly the Republicans are not going to raise problems that the Democrats are going to charge that they should have resolved. What will happen after the election is over?

Let me first offer the evidence that suggests that economic relations with Japan will be a lot better than they have been.

I ask you to think back less than 2 years ago to the state of Japanese-United States relations. In December 1982, Ambassador Mike Mansfield rose to say in an address to the Yomiuri International Economic Society, that we confront a "challenge to the entire postwar structure of international and economic cooperation unprecedented since the days of the Great Recession. . . . Our ability to manage the crisis of worldwide recession and unemployment in a manner consistent with the principles of free trade and mutual cooperation upon which our prosperity has depended for the past 35 years is at stake".

Those sentences don't describe today's mood. What changed? Both the Japanese and the United States' economies have turned upward. That helped. But the challenge that Ambassador Mansfield addressed was not the economic conditions themselves, but the ability to respond to them. In short, the challenge was political not economic. What changed? Japan acquired a new Prime Minister, Yasuhiro Nakasone. And he and President Ronald Reagan hit it off.

That friendship has permitted Prime Minister Nakasone to take dramatic steps that he might not have been able to take otherwise. That friendship brought President Reagan to rein in a bureaucracy that was creating more problems with Japan than it was resolving.

Equally important was the atmosphere that the President and the Prime Minister created. Both men are open, optimistic, and confident. Soon the relationship reflected their common personality. Both countries do best under these conditions.

What will happen in the future? I leave to others to explain who will win the Presidential election. Prime Minister Nakasone, too, must stand for reelection this autumn, November 21, for the Liberal Democratic Party presidency, in reality, the election for the prime minister since the LDP controls a majority of the seats in the lower house of the Diet and it elects the prime minister by a majority vote.

Already, it seems clear that Prime Minister Nakasone will win this election handily. But what will happen 2 years hence, in November 1986, when the party rules say that Nakasone must step down? The Japanese public is both quick to judge and to judge harshly its political leaders. A common pattern for a prime minister is to reach his greatest popularity shortly after entering office and then to go into decline, never to recover, eventually to be replaced. How long does the process take? Two years. Japan has had six prime ministers over the past 12 years.

Although Nakasone has already defied this process and gained in popularity, most commentators assume that he will burn himself out in the next 2 years and the public will welcome his replacement.

I don't share this view. I believe that Nakasone has just gotten his sea legs. And at the end of 2 more years, he will be even more popular and his policies will be more broadly accepted than he is and they are today.

What will the party do? Effectiveness and popularity are valuable political commodities, not to be thrown away readily. One reason that the party has been able to remain in power since its inception almost 30 years ago is that it has proved capable to recognize and adapt to reality. I cannot but think that the party leaders will find a way to continue Nakasone in office.

What happens, though, if he must step down. No man is indispensable. Other competent men wait for their chance to sit in the prime minister's chair. One of them will take over. The relationship will not be the better for it. But it won't be the worse, either.

It is possible to argue that the economic difficulties that we have been having with the Japanese do not have economic origins. Rather the issue is fairness: the Japanese have violated the American sense of equity. Leaning upon the liberal world order to support their reconstruction, the Japanese now refuse to support this international order even though they have achieved major power status. That refusal extends even to relying on other nations to defend it. Japan, in short, still wants a free ride.

Prime Minister Nakasone put an end to the free ride. At least, it has not been heard about extensively since he came to office. Recognizing the linkage between equity and economics, and for other reasons, he launched Japan on an active diplomacy, encompassing nations around the world but concentrating on the nations within East Asia.

Is it possible that this diplomacy may be too active? In studying American diplomacy in East Asia, many scholars have discovered a constant: the United States has always opposed any nation that has attempted to establish dominancy in the region. Except for the city states of Hong Kong and Singapore and the island of Taiwan, the Japanese economic presence in the East Asian nations is greater than that of the United States.

In 1899, Secretary of State John Hay sent notes, the so-called open door notes, to the major powers asking them to subscribe to the principle of equality of commercial opportunity in China. One reason we entered the Pacific War in 1941 was to sustain the open door. Since 1945, we have been the dominant power in East Asia. Now we are losing that dominance. Shall the open door again become a dominant theme of our East Asian policy?

I think not. Japanese and United States' goals in East Asia are close if not identical. The Japanese are not trying to shut out United States' interests, though some United States manufacturers may allege so. The other East Asian nations exhibit disquiet about Japan but not to the extent of limiting Japan's purchases and investments.

Rather I think the danger lies with Prime Minister Nakasone's unalloyed success. He has yet to fail in his foreign policy. Given the risks he is taking and the fast pace that he is running, failure is a possibility. Will Nakasone's foreign policy survive? Yes. Will he have to slow down? Two of the three announced rivals of Prime Minister Nakasone for the prime minister's chair have been foreign ministers. They know a failure when they see it. One rival heads a faction, some of whose members believe that Nakasone is being too active. They would like a more cautious, gradualist approach.

A third reason that economic relations with Japan will improve is that Americans now know a great deal more about Japan and are beginning to exploit this knowledge for commercial gain. Americans have turned bullish over their ability to compete.

In the early sixties, American textile manufacturers realized that the Japanese could out-produce them and asked for measures to restrict Japanese imports. But for most Americans, the thought that the Japanese were formidable competitors did not really begin to sink in until the Japanese began to make and export a better car.

Americans first thought that the Japanese had to be doing something illicit. They were secretly subsidizing their industries. Through patriotic appeals, Japanese manufacturers, if not government officials, had convinced the Japanese consumers not to purchase foreign goods. They had kept their labor movement weak which meant that they did not have to pay high wages.

When these explanations proved inadequate, Americans moved on to cultural explanations. As a latecomer to industrial society, Japan had been able to leapfrog predecessor nations. Japanese had finessed outmoded practices that hampered high productivity. They had developed a superior management style. They had industrial policies.

These explanations, too, proved inadequate. But through the process of exposing these inadequacies, Americans have come to realize that there is nothing intrinsically superior or inferior about the Japanese economy. It has both strengths and weaknesses. The weaknesses can be exploited. American companies are beginning to move on shore.

Two myths remain however. And I would like to hasten their exposure.

The first myth is that the Japanese government has put together a superior bureaucratic system and that the American government would do well to emulate it. We should build a DITI (Department of International Trade and Industry).

Japanese bureaucrats are highly competent. Their selection process insures that. But they do not monopolize political power. That is diffuse. Each ministry must battle other ministries. And the ministries must report through the party organs, the Policy Affairs Research Counsil in particular, to the politicians each of whom has interests to advance. Decisions reached in the party are introduced into the Diet where opposition parties modify them. Japanese decision-making is complex. It is enough that the Americans understand how it works. I see nothing in the process to emulate.

The second myth is that the Japanese are out to bury us. Nothing could be further from the truth. Almost to a man, the Japanese want a strong United States; there are many reasons why: the simplest explanation is economic. The United States is Japan's most important market and Japan's prosperity depends on the United States' prosperity.

Other evidence suggests that economic relations between Japan and the United States will continue to be contentious.

The United States has a large and growing trade imbalance with Japan. The economists may argue that such a deficit is to be expected in times of economic recovery and that a bilateral trade deficit is not important so long as the multilateral accounts are more or less in balance. They may be right, though they have not had much success in getting their argument accepted. The sums we are talking about are unprecedented, and any unprecedented problem usually invites an unprecedented solution. No doubt the Japanese will be asked to provide such.

Every year, the Economic Planning Agency in Japan prepares an economic White Paper, which among the many economic documents the Japanese government issues, probably attracts the most attention. This year's White Paper said that the trade imbalance in Japan's favor was structural," meaning it would continue to be in Japan's favor for many years into the future. The EPA offered, and the Japanese cabinet accepted, the recommendation that Japan become a major capital exporting nation.

This decision is profound. It may become significant event historians use to mark Japan's emergence as a major power. Certainly Japan's foreign outlook and foreign policy will change as Japan becomes more and directly involved in the economies of other nations.

Some of this capital will come to the United States. The money that is invested in the market and in government bonds will be welcome. Less certain will be the reception given to money used to buy land and companies. Nonetheless, the Japanese presence will become more familiar to the American citizen and more integral to the United States economy. It will be harder to identify the Japanese as "they" in the "we-they" scenarios we often project.

But investment is not enough. Japan would be well advised to search out new commodities which it can purchase from the United States. The only commodities that stand any chance of significently redressing the bilateral trade imbalance are natural resources—coal, oil, natural gas, hardrock minerals, timber, and fish. Arranging for Japan to purchase and import these commodities is both politically and economically difficult.

Many of our commodities are not internationally competitive. They have been hedged in by regulation costly and difficult to remove. North Slope oil is a case in point. Though the security reason for restricting its sale to domestic purchasers has long ago vanished, the maritime union, whose members on American ships must transport this oil has found hidden treasure. It has successfully resisted relaxing export restrictions.

The Alaska oil case is not singular. The Japanese must do battle—or have battle done for them—with very powerful domestic interests if they are to purchase commodities at an internationally competitive price.

There is another reason why the Japanese will not significantly increase their purchase of United States commodities. For many years, Japan has been going overseas to acquire natural resources for present and future consumption. Japanese firms now have well-established ties through the world with companies that supply them with raw materials economically, steadily, and reliably. In many cases, these raw materials were developed with Japanese capital. Japan will not walk away from these sources to develop new sources in the United States.

The Japanese Government may understand the political benefits to be derived from purchasing United States' resources. But it cannot readily act on this understanding. A common explanation of the Japanese establishment is that it is divided into three groups—Liberal Democratic Party politicians, senior bureaucrats, and big businessmen. Through supplying funds to run the party and hold elections, the businessmen maintain influence with the politicians. Through the power of appointment and the power to decide policy, the politicians control the bureaucrats. Through the power to license, to tax, and to regulate, the bureaucrats speak out to the businessmen. No group predominates. For the Japanese Government to decide and move, all the three groups must be in accord. The business group is amorphous and hard to define. But at its core, often speaking for it, are the companies that deal in basic commodities. Their economic interests will not be sacrificed for political advantage.

The greatest exacerbation to the smooth functioning of economic relations between Japan and the United States stems from the type of diplomacy the two nations practice with each other.

For at least the past decade, perhaps longer, the tendency has been for each Japanese ministry and each United States' department to practice its own diplomacy. Each department and ministry usually sends its own men overseas. In the case of the United States, these officials find desks in the Embassy, nominally under ambassadorial control. In the case of Japan, government officials can be found both within the Embassy and outside. Along the Eastern seaboard, for example, MITI has posted some 30-odd officials in various trade associations and other offices. The Ministry of Finance has 16 officers externally posted. In the United States' case, negotiators fly from Washington to Tokyo. The Japanese make less use of negotiators originating in Tokyo.

What is wrong with every body doing his own thing?

1. Many problems fall within the purview of several agencies. Agencies compete to become the responsible agency. In the United States, the agency that takes the hardest line or can prove itself most aggrieved becomes the responsible agency. In Japan's case, even though an agency fails to win primary jurisdiction, it conducts its own diplomacy, anyway.

2. Many times, a Japanese Ministry will ally with an United States department to thwart the interests of another alliance composed of another Japanese ministry and another United States department. Japanese often use their alliance partners to speak out against the Japanese Government. This practice puts the United States' officials right in the midst of a Japanese domestic political battle without really knowing what they are doing or saying.

3. There is competition among the United States departments to have their problem receive top level (White House) attention. Often this competition takes the form of making a problem seem more important than it is.

4. There is no way to establish priorities except through inter-departmental negotiation.

5. A national diplomacy in which each department can pursue its own course of action independently makes planning impossible.

6. Under this diplomacy, the public and to a lesser extent, the Congress and the White House find it difficult to discover what is really going on since no one really knows.

Recently, President Reagan has said that the State Department will be the prime department for managing foreign affairs. Prime Minister Nakasone has made clear in his writings, that he, too, appreciates and intends to follow classical practice. Perhaps traditional diplomacy is to be given another chance. But still remaining strong and virulent are the reasons that broke up classical diplomacy—the growing complexity of problems and the desire of specialists to negotiate their own affairs.

Study, then, of the practice of diplomacy is called for, since diplomacy itself can create problems as well as resolve them. Several years have passed since the United States set up a foreign commercial service run by the Department of Commerce. Has the time come to see how it has bettered the conduct of American diplomacy?

No further study is necessary to conclude that United States' ecomomic diplomacy toward Japan has suffered from the deterioration of quality in our Japanese language officers. Language officers are ranked in speaking and reading ability from one to five, with three being the minimum necessary to perform a job designated for a language officer and with four in both speaking and reading being the desireable level for professional competence. Of the 151 Foreign Service officers on the Japanese language list, only nine are ranked four or above. All are political officers. In the last decade, only one FSO has become a four as a result of State Department training. All others have acquired their Japanese language ability before entering the Foreign Service.

Only one of the top four slots in the economic section in the American Embassy in Tokyo is designated for a language officer.

Although extra pay is now given for learning Japanese, few officers want to do so. It takes too long to acquire any competence. It precludes them from getting the broad experience necessary to be promoted to the senior ranks. Last year, only one Japanese speaking FSO was promoted to the senior ranks. This year, none. Meanwhile, three Japanese language officers retired since they knew that they would be selected out for being in grade too long without a promotion. Several more Japanese language officers can be expected to retire for the same reason next or the following year.

Senator MURKOWSKI. Thank you, Mr. Thayer.

Our next witness will be Mr. Patrick. Mr. Patrick is R.D. Calkins professor of international business. Please proceed.

STATEMENT OF HUGH PATRICK, R.D. CALKINS PROFESSOR OF INTERNATIONAL BUSINESS, GRADUATE SCHOOL OF BUSINESS, COLUMBIA UNIVERSITY, NEW YORK, NY

Mr. PATRICK. Thank you very much, Senator Murkowski. I have a prepared statement for the record.

Senator MURKOWSKI. Your entire statement will be entered into the record.

Mr. PATRICK. Thank you.

In that statement, I stress the need always to assess the bilateral economic relationship between the United States and Japan in broad perspective in several dimensions. First, it is part of an overall alliance relationship with Japan.

Second, what the United States and Japan do together has implications for the rest of the world, since we are the largest and second largest market economies in the world. So it has to be seen in a global context.

Third, we have to see this relationship in longer run perspective. We need to look beyond the immediacy of important issues in order to see them in these broad contexts.

One of the dangers is that all too often United States-Japan relations get hung up on small issues which become heavily politicized and do not have much economic content, as you noted in your comment about the limited impact of full liberalization of oranges and

beef for U.S. exports. We spend an ordinate amount of time and chips on the wrong issues, in my opinion.

I do not want to comment in any detail on the report issued recently by the United States-Japan Advisory Committee. You entered their executive summary into the record. I think it is a very good report. I read the report after I prepared my own statement and I find that we are emphasizing very much the same sorts of themes.

We need a package of policy actions in both countries, and the package has to be both macroeconomic and microeconomic. We have to be concerned about the dollar-yen misalignment and growth rates in both countries, and we have to be concerned about institutional and policy changes—as has already been mentioned, for example, the American ban on the export of Alaskan oil, as well as problems of further access, not only to the Japanese markets for goods and services but financial markets as well.

So it is not just either macro or micro; it is both. And it is not policies just in Japan; it is policies in the United States as well.

I want to address three key issues which face our economic relationship and which need to be addressed by our governments soon after the elections take place in both our countries.

First is the issue of Japan's leadership role, which is mandated now by its economic position in the world. I think the Japanese are gradually coming to recognize that the Japanese economy has entered a new era. It is no longer the old postwar era.

Japan has finally caught up with the West in standards of living, incomes and productivity, and technology. It is no longer a follower. Moreover, it is now a big player in the world economic system. But whatever it does or does not do has repercussions on the rest of the world, as we certainly know very well, and it is inevitable that the United States and other countries will react.

Japan's growth prospects are good, but they are no longer superfast. But that is at a high level of affluence. As both the environment within Japan and Japan's relations with the rest of the world have changed, gradually Japanese leaders are coming to recognize that they must take a more active leadership role.

The most important leadership role Japan can take is to continue to open up its own markets. That is the act of a strong leader, to maintain our international economic system, and that is the pressure that Japan is under, and appropriately so, not only from the United States and Europe, but from the developing countries, including ASEAN and others.

A second issue I stress in my prepared statement is, will protectionist actions play an expanding role in American economic policy or will the U.S. Government reaffirm an open, relatively free market-oriented trading system in practice as well as in rhetoric?

The United States-Japan Advisory Commission report stresses that the dollar-yen misalignment is a key issue at the macro level for this relationship. If the dollar were less high and the yen were more appropriately valued in world currency markets, that would have a substantial impact on our trading relationship, both bilaterally and multilaterally.

I agree with that report on this and I feel that, frankly, the key is the U.S. Government budget deficit. The most important single

act the United States can take to improve its balance of payments relationship overall and with Japan is to reduce the U.S. Government deficit substantially.

A second bellwether decision for U.S. trade policy in terms of whether we are moving protectionist in our own perceptions and those of the rest of the world or whether we are reaffirming a free trade policy is how we deal with the so-called voluntary export quota arrangements on automobile imports from Japan: Will they be allowed to expire next spring, as scheduled, or will they be extended?

I urge that they not be extended. I think they are both a symbol and a quantitatively important fact of the new protectionism, as it has been described, in the United States, and I think that is not the direction in which we should move.

Third, I want to mention the development of new high technology industries as a dynamic and rapidly changing feature, increasingly important for both our economies. I think it is misleading to see this as a high-tech shootout between our two countries. The fact of the matter is that we are getting increasing cross-licensing, increasing trade, increasing investment by American high-tech firms in Japan and Japanese firms in this country.

The important policy issues are: that import restrictions not be used to promote these high-tech industries in Japan or in the United States; that foreign firms be given equal national treatment, for American firms in Japan and Japanese firms in the United States; and that the military and security issues that are related to high tech industries be worked out on a cooperative basis.

Frankly, I think the real issue in the coming years is not going to be the United States versus Japan in high tech, but how the Europeans are going to deal with the reality of very strong American and Japanese firms in high technology industries when their own firms and industries are lagging behind.

In my prepared statement, I discuss Japan's growth prospects over the next 10 or 15 years, and I see them as quite good, better than the United States, basically because they have a higher savings rate, which enables them to engage in high investment, though it also poses problems for them in terms of domestic demand. We have the opposite problem of inadequate savings, inadequate investment, and therefore the dilemmas of less rapid growth than I think is optimal for our society.

Finally, I consider six scenarios of long run possible futures. I do not want to go through those here. I might point out that the optimistic scenario is a world in which the United States and Japan take positive leadership, reaffirm the commitment to an international system of open and free trade. Japan has to be better integrated into that system and it has to take the leadership in integrating itself into the world economic system in order that we have such a world again. In other words the 1980's and 1990's would be a reaffirmation of the open system that we had in the 1960's, with the 1970's as a turbulent an interregnum.

That is the optimistic scenario. A pessimistic scenario is that indeed we all will retreat into protectionism. Either it will result in regional blocs, which I think would be very harmful for all of us,

including the Japanese, and certainly for America; or more likely is what I call sectoral protectionism, in which we will have restrictions on trade, possibly de facto world cartels, not just in textiles and shipbuilding, but in steel, automobiles, a whole range of basic industries.

I think there is a real danger that we will slide into that kind of protectionism, which is so inefficient and dangerous, though probably it would not be particularly harmful for the United States-Japan relationship, because many Japanese are quite willing to go that kind of market-sharing route. But it is a dangerous route, partly because it is seductive.

A third scenario is the United States might try to isolate Japan with special quotas or restrictions or tariffs that are Japan-specific; certainly if we were to do that the Europeans would follow very quickly. That would be even more dangerous, and would certainly in the long run break down the alliance between the two countries. I think we would find Japan responding very vigorously and dynamically to such a challenge and in ways that we would find not to our long run economic interest, much less our security and political interest.

Thank you.

[Mr. Patrick's prepared statement follows:]

PREPARED STATEMENT OF HUGH PATRICK

Introduction

The United States and Japan are the world's first and second largest market economies. Together they produce about one-third of world GNP as measured by market exchange rates and engage in about one-fifth of the world's trade among nations. The bilateral economic relationship is extremely large, prosperous, and important.

On average the productivity of the Japanese economy is about four-fifths that of the American. But that masks a substantially wider variance in productivity among sectors in Japan than in the United States. On the whole Japanese manufacturing is highly productive, and in some industries -- steel and automobile for instance -- labor productivity is above or at least equal to that in the United States. However, the Japanese economy is burdened by an agricultural sector which, while technically efficient, is economically very inefficient. In the service sector too there are many pockets of low labor productivity, best exemplified perhaps by Mom and Pop retail stores relying on family labor. In contrast, wage rates in manufacturing vary substantially more in the United States than in Japan. In recent years wages in the steel and auto industries have been 70-80 percent above the average for all manufacturing workers in the United States, and about 30 percent above the average

in Japan. The combination of productivity and wage differentials across sectors substantially affect the competitive advantages of firms in both countries.

The United States-Japan economic relationship is also, inevitably given its very size, subject to many tensions emanating from different sources and of differing degrees of importance. These include various de facto restrictions on American access to the Japanese market ranging from most agricultural products and cigarettes to certain other manufactures as well as services; and restrictions on Japanese access to the American market, automobiles and steel most prominently but numerous other items as well. They include also differences in institutional arrangements and policies, for example, restrictions on American access to Japanese financial markets, the unitary tax laws of certain American states which affect Japanese firms investing in them, , a Japanese tax system which encourages saving and an American tax system which encourages consumption. Many American manufacturers face intense competition from Japanese firms, in the American market and in third country markets. Many Japanese products, some in manufacturing and virtually all in agriculture, face intense competition from U.S. producers in their home markets. The bilateral trade balance has become a symbol, inappropriately so, of many of the economic tensions between the two countries.

Perhaps the greatest danger in the management of the United States economic relationship with Japan is that it tends to be placed, in both countries, in much too narrow a context. Technical issues, or issues of modest economic significance, become politicized and somehow mistakenly come to be viewed as matters of principle rather than items to be dealt with through the nitty-gritty of negotiations. The importance of the bilateral relationship, and indeed of each country to the other and to

the world, is so great that it must be viewed in a far broader context. That context has three dimensions: the overall bilateral relationship which involves mutuality of political and security as well as economic interests; the global context, in which both the United States and Japan exercise leadership in the maintenance and effective operation of the international economic system; and the longer-term context of the economic relationship over the next 10-15 years, in both its bilateral and global systemic implications.

The bilateral trade balance must be evaluated in the multilateral context of the overall, global balance of payments of each of the two countries, and in longer-run perspective. Thus, just two decades ago Japan had severe import restrictions, and was only beginning the process of opening its markets to foreigners. At that time the United States had a bilateral trade and current account surplus with Japan. In those two decades Japan has substantially liberalized imports, while the United States has raised some barriers to imports -- yet the earlier bilateral surplus has turned into a very large deficit for the United States. Clearly many more factors than trade barriers have brought this about: Japan's rapid growth and new, highly competitive industrial structure; the oil crises and other shocks to the world economy in the 1970s; and more recently the extremely high value of the dollar relative to all other currencies including the yen.

I focus here primarily upon some longer-run issues of the future the United States-Japan economic relationship. Nonetheless, while the relationship has been quite well managed over the past year, several key issues have not yet been dealt with adequately and will have to be tackled soon. Moreover, major parameters shaping the relationship are

changing in both nations. It is likely the decisions -- or non-decisions -- reached over the course of the next two years will be crucial in determining the nature and shape of the United States-Japan relationship in the longer run. Fortunately evolving conditions in both countries, both cyclical and longer-run, provide an opportunity for constructive resolution of these issues.

Evolving Conditions

First, near-term economic prospects appear good in both countries. The American economy has been rapidly recovering from its worst recession since the 1930s. Prospects seem reasonably good that this process will continue at a desirably more moderate pace. Japan is currently growing more rapidly than earlier projected; the government's fiscal 1984 growth rate projection was recently raised from 4.1 percent to 5.3 percent; stimulus has come from business investment, through the net increase in foreign demand (exports minus imports) still contributes about one-third of the total increase in demand. And this growth is taking place without renewed inflation in either country.

Second, the elections will be behind us later this fall: the Presidential elections in the United States and the Liberal-Democratic Party presidency and hence prime ministership in Japan. Regardless of the results -- and both incumbents are likely to remain in office, barring unforeseen changes -- the most important consequence it that the ending of the election season will allow the U.S. Congress and the Administration to tackle the huge budget deficit. That is not only the most important single domestic economic issue, it is perhaps the single most

important source of the immediate difficulties in the U.S.-Japan economic relationship.

Third, assuming the Reagan Administration continues in office, there is some indication that early next year it is likely to make the Pacific, and Pacific Basin economic cooperation in particular, a significant new foreign policy thrust. The Administration decided to join business and academe in establishing, on September 18 of this year, the tripartite National Committee for Pacific Economic Cooperation, with the personal endorsement by the President to the committee members in a White House reception that day. This will add a regional dimension complementary to the traditional American bilateral approach to Japan and other Pacific nations, within the framework of ongoing commitments to the international economic system and its institutions. Such an American policy would also be complementary to Japan's own Pacific Basin interests. The appropriate and effective management of such a new policy will take considerable thought and effort by both the United States and Japan in their dealing with the other nations of the Pacific.

Three Key Issues Facing the U.S.-Japan Economic Relationship

The U.S.-Japan economic relationship faces three key issues. First, will Japan be able and willing to take on the appropriate leadership role in the international economic system desired of it by the United States, Western Europe and indeed all market economies? Second, will protectionism play an expanding role in U.S. economic policy, or will the government re-affirm an open, relatively free, market oriented trading system in practice as well as rhetoric? Third, how will the two countries deal with the rapid development of new, high technology industries,

domestically and in their economic relations with each other and with the rest of the world? Let me comment briefly on each.

The ability and willingness of Japan to exercise international leadership involves multi-faceted and complex issues. Japan is likely to continue to move ahead more rapidly in the economic than in other areas. The most important act of international economic leadership is that Japan continue to open its domestic markets to American and other foreign access, in practice as well as formal act or symbol. In fact a great deal of progress has been made, and Japanese leaders are to be complimented on that. Nonetheless, many important pockets of protection remain -- in virtually all of agriculture, some manufactured goods, and in some areas of finance and other services. The process of opening up Japanese markets is complicated and at times subtle. It requires not only changes in government policies but in institutions and in Japanese perception and attitudes.

That process in underway. Japanese are coming to realize that Japan has entered a new era, in its domestic economy, in its economic relationship with the United States, and in its role in the world economy. There are several elements of discontinuity which suggest the emergence of a new era. First, in the 1970s after more than a century of effort Japan finally "caught up with the West." It attained levels of affluence and standards of living comparable to Western Europe and the United States. Income is relatively equally distributed, educational attainment is high, crime rates are low. Some 90 percent of Japanese identify themselves as middle-class. Moreover, in many industries Japanese firms have now caught up in a technological sense; no longer followers, they

are at the frontiers of applied knowledge, and are highly efficient in commercial application of R and D.

Second, the postwar era of Japan as a relatively small player in the international economy came to an end in 1971 with the "Nixon shocks." The Japanese economy has become so large, its share of global foreign trade so significant, and the American and other foreign perception of Japan as so economically strong and dynamic, that Japan can no longer expect no repercussions to its own policies and actions. As the strains in the U.S.-Japan economic relationship, and Japan's relationships with many other nations, over the past decade have shown, Japan cannot ignore foreign reactions to what it does or does not do.

Third, Japan has entered a new era of substantial but no longer super-fast growth. The GNP growth rate has declined sharply -- from an annual average of about 10 percent between the mid-1950s and the early-1970s to less than a 4 percent rate in the decade from 1973. This dramatic slowdown in growth of output and labor productivity has many causes; the 1970s were as unsettling for Japan as they were for any advanced industrial economy, though Japan's economy continued to perform better. Japan has found itself since the mid-1970s in a situation of still very high private savings but only moderately high business investment demand, hence deficient private domestic demand, and huge government budget deficits.

So Japan has entered a new era: affluent, with high rates of employment and inflation well under control, but with reduced future growth expectations, and in a world by no means willing to take Japan for granted, or to allow it to pursue past policies and practice with impunity. Its major international challenge -- and opportunity -- is to

exercise responsibly its economic power. Its failure to do so adequately will only enhance the American frustration over the perceived slowness of the process of Japanese liberalization, and could result in heightened tension and a worsened relationship.

In the United States in recent years, certainly the economic and political forces in practice have been toward raising import barriers, despite policy commitments in principle to free trade. While the economic recovery has reduced somewhat the protectionist pressures, they have been exacerbated by election-year politics. With the steel import decision behind us -- at least for a while -- the key decision coming up for United States trade policy, especially vis a vis Japan but more broadly in both symbolic and substantive senses, is whether the so-called voluntary export quota arrangement on automobile imports from Japan will be extended beyond its current expiration date next spring. I regard that as a bellweather decision in the policy debate over open multilateral trade versus protectionism. The relatively open, multilateral international economic system will not persist in the absence of U.S. leadership, which requires that the United States as well as Japan maintain open access to its markets. Further American slide into protectionism will have serious, adverse repercussions for the U.S.-Japan relationship.

Third, the overall GNP growth rates of both the United States and Japan tend to mask the great vitality, dynamism, and rapidity of change in the high technology industries of the two economies. This is apparent today particularly in microelectronics -- in the widening range and burgeoning use of semiconductors, computers, and the telecommunications sector. Firms in both countries are at, or very close to, the

technological frontiers in their respective fields. Japanese firms are ahead in some high technology products, behind in many. There are no comprehensive or simple generalizations. Perhaps the most important characteristic in both countries is the rapidity of change. It is not easy for the government to pick winner industries, much less winner firms, when a country is at the technology frontier. Old policy instruments are no longer so effective, or are no longer available under the present rules of the game, notably restrictions of imports of high tech goods. On the other hand, both governmental R and D support and government procurement are important -- in both countries. We should not underestimate the rapidity of change in the industrial scene in Japanese high technology, much less in the United States. In Japan new firms are entering; existing firms are moving into high technology areas; new groups of companies are being formed based on technological and marketing complementarities rather than historical ties; the government-business relationship is changing; as traditional jurisdictional boundaries become less and less relevant, turf conflicts among Japanese ministries and other government agencies have risen dramatically.

It is not clear to what degree and in what ways competition between American and Japanese firms in high technology industries will become a significant source of bilateral conflict at the public policy level. There already is considerable cross-licensing and other joint arrangements between American and Japanese companies, and considerable investment by each in the other's country. This will increase, and as it does the bilateral context of competition will become more blurred. Certainly it is misleading to regard Japan and the United States as involved in a "high tech shoot-out." In reality both countries are leaping ahead of

all others. Probably the important issues will not be in terms of the United States versus Japan, but will involve both vis a vis a lagging Europe attempting to catch up with both the United States and Japan.

These issues are before us today. It is likely they will remain at the top of the agenda for some time to come since their full resolution is never-ending, only being re-defined and re-considered as circumstances continue to change. In the longer-run, the next 10-15 years rather than the next two to three, the nature of the bilateral relationship will depend fundamentally upon the evolving characteristics of the new era into which Japan's domestic economy has apparently entered, and on the evolving structure and characteristics of the international economic system itself, especially dependent as it is and will continue to be upon American leadership. I speculate upon these two themes -- raising questions rather than answering them -- in the next two sections.

The Japanese Economy Entering a New Era

The Japanese economy is entering a new era in a double sense: its postwar period of superfast growth has come to end (a decade ago now) after bringing Japan to the forefront of large affluent nations, and Japan's century-long effort to catch up with the West has been in essence achieved. What are major domestic economic issues Japan will face over the next 10-15 years?

The most important economic issue has to be the growth performance of the economy. Will Japan's long-run growth trend be relatively high (5-6%) or relatively low (at the historic and projected United States rate of 3%)? A dynamic, rapidly growing Japanese economy would in the long run have a profound impact on the world, and upon its ability to

deal with the rest of the world on its own terms. It is in itself important that fast growth for Japan is now defined as six percent rather than the ten percent rate of the 1960s. It is equally important that slow growth for Japan is perceived of as three percent rather than zero or some smaller positive rate.

An arithmetic exercise illustrates the point of a continued increase in Japanese economic power. Today Japan's total GNP in real purchasing power terms is about two-fifths that of the United States; given Japan's population of 120 million, its GNP per capita is about four-fifths the U.S. level. If Japan were to grow at an average rate two percentage points faster than the United States, then in one generation (36 years) Japan's total GNP would be four-fifths that of the United States, and its GNP per capita (and standard of living) 60 percent above that in the United States. The implication would be profound. Projections prepared by the advisory Long-Term Outlook Committee of Japan's Economic Planning Agency are less extreme. An average annual growth rate between 1980-2000 is assumed of 4 percent for Japan, 2.5 percent for the United States and Western Europe, 3 percent for the USSR, and 4 percent for China. The projected respective shares of World GNP in the year 2000 are: Japan, 11.9 percent; the United States, 19.6 percent; Western Europe, 23.3 percent; the USSR, 12.5 percent; and China, 5.3 percent.[1]

The sources of growth engender some optimism for Japan's prospects. The three key issues will be the savings rate, productive investment demand, and invention/innovation. While the aging of the Japanese population may be a negative factor, the results of studies by Denison,

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[1]Long-Term Outlook Committee, Economic Planning Agency, Japan in the Year 2000 (Tokyo: The Japan Times, 1983), pp. 40-42.

Kendrick and others suggest that numbers of hours worked are not an important source of growth relative either to increases in capital stock or technological change. Quality of labor, innovation, and consumption demand are the most useful human contributions to growth. The high ratio of labor force to total population in Japan will not decline until after the year 2000. The composition of non-workers will change sharply, with fewer children and more old people; this will pose special problems for Japanese families and for Japan's social security system.

One of the puzzles of Japan's postwar economy has been the increase in the personal saving rate to extraordinary levels as a share of disposable income. There is no single cause which brought this about. Specialists have not yet succeeded in assessing the relative importance of many plausible reasons for Japanese saving behavior, and therefore it is particularly difficult to predict future saving performance. It is my judgement that the personal saving rate may decline somewhat but will continue to remain high (in the range of 15-20 percent of personal income). This should provide the wherewithal for high rates of Japanese domestic and foreign investment.

Will the aggressive spirit of Japanese businessmen, large and small -- to expand, create new products, substitute capital for labor and/or natural resources -- persist? Will the "animal spirits" of the entrepreneur give way to much less expansion-growth-oriented leaders? Probably not, provided the economic environment remains reasonably good. The spirit of growth is sufficiently strong in Japanese society that entrepreneurs (in whatever guise) will be forthcoming. The problem then will be the conduciveness of the social, political and economic environment to investment activity, at home and abroad.

Now that Japan is at the frontiers of technology in many fields, it will no longer be able to reap its earlier advantage of being a late-comer. New knowledge will not be as cheap to obtain or as forthcoming -- from abroad or from domestic effort. However, one can easily foresee a continued strong effort by business and government to encourage commercially applicable research and development. Can Japan continue to pursue a follower strategy in basic science: letting other countries do the basic research which Japanese scientists and technicians then learn and apply commercially? Or will the information channels at the frontiers of knowledge be sufficiently clogged that Japanese firms will lose out in the timing of the application of new products and processes? The Japanese economy and society have now reached a level at which it is unlikely that policymakers will continue to rely so heavily on the foreign pool of basic scientific knowledge. One can anticipate that, once present budgetary difficulties are overcome, a major new policy thrust will be to develop the basic sciences -- at least those most relevant to economic growth.

It has sometimes been suggested that the nature of Japanese society is such that it inhibits the development of individual initiative and creativity. Imitation is an important positive factor in the process of economic development, essential for all who are trying to catch up to the frontiers of knowledge. That Japanese have been able to imitate, adopt, adapt, and now improve foreign technologies has been a very wholesome force in Japan's economic history. In that sense, it is important to emphasize that Japan's innovative creativity in the technological spheres is only beginning to be tested -- at least in terms of major innovations. While Japanese society does place great pressure on conformity and

stifles individual deviance, this does not mean that the creativity of Japanese has been or will be so repressed as to make if impossible for the nation to produce basic scientific advances. Moreover it appears now that basic science at the world level has become a more institutionalized, team (or group) activity -- a mode of organization in which Japanese excel. It would be misguided to assume that Japan's ability to innovate will be hampered by lack of creativity.

Indeed, one of the assets of Japanese society is that new technologies can be rather rapidly learned and widely disseminated. Japan is in a relatively favorable position to adapt to the computer age. A centralized secondary educational system with uniform and high standards and a homogenous population could assure high average skill levels with modest variance -- i.e., most people competent to interact with and service the machinery of the information era. The United States will have a more difficult task.

But achievement of the growth potential of the Japanese economy depends not only on the supply side. The ending of Japan's rapid growth era created a situation of deficient private domestic aggregate demand persisting for a decade. It is unclear whether this is a cyclical matter, representing the disruptions of the traumatic 1970s, or a secular phenomenon. For any long run analysis, however, it is essential to ask whether the growth potential of the Japanese economy will be matched by sufficient domestic plus foreign aggregate demand.

While American and other policymakers call for greater capital outflows from Japan and more direct investment abroad by Japan, some are unwilling to accept the surplus of exports over imports of goods and services that such a policy implies. Some policymakers at times appear

confused between net capital outflows which require a concomitant surplus on current account, and gross capital flows of certain types offset by inflows of other types. Over the past decade Japan has become an international financial intermediary, borrowing short and lending long (including direct investment abroad), while its cumulative net capital outflow was small through 1983. With high domestic savings and moderately high investment rates, it might be expected that the surplus of private Japanese saving will flow abroad, requiring current account surpluses up to several percentage points of GNP. This would amount to a merchandise export surplus in the tens of billions of dollars, which would probably be unacceptable to the United States and Western Europe since their structural adjustment problems in important industries would be exacerbated. It is not at all clear that the adjustment mechanisms of the world economy will tolerate the generation of substantial aggregate demand within Japan through the net export of Japanese capital and goods.

A key question for the future then is whether Japanese private domestic demand will grow adequately. Will the savings rate come down (the consumption rate go up) sufficiently to balance private investment demand? Alternatively, will private investment demand once again increase sufficiently to use up private domestic saving? This is probably the most important macroeconomic issue facing the political economy of Japan in its new era. If private domestic demand is inadequate, then an expansive government policy to encourage demand will be required, either through an easy monetary policy and low interest rates or through an expansive fiscal policy (a larger government budget somewhat closer to balance or a smaller government expenditure program but with continuing budget deficits). The economics may be straightforward, but the politics

are exceedingly difficult. In practice, one way this may come about will be through rising government expenditures as the population ages, for presently mandated retirement and health benefits, financed by persisting government deficits.

There are other features of Japanese society which may have a great impact in defining the nature and characteristics of Japan's new era. How will the new nationalism evolve? Will it be inward-looking or outward-looking? It could be argued -- popular American opinion to the contrary notwithstanding -- that up to now Japan has been quite outward-looking, seeking to accommodate itself to the United States, but that this will become less true in the future. How will the middle class (new mass) society evolve? One would anticipate that it will be relatively stable and change will be slow.

Will the "Japanese system" of economic institutional arrangements and policies persist? Which elements will endure, which will change? These are issues that must be addressed, both for analysis of Japan's domestic political economy and for its relations with other nations -- because surely some of its elements will be under considerable foreign pressure.

The International Economic System: Alternative Futures

Japan is a major participant in the world system and its future will depend upon what happens in the rest of the world. Has the 1973-83 decade been an interregnum for the open, market-oriented international economic system to which we will return; or does it represent the ending of the post World War II era and the beginning of a new, as yet not clearly defined period of world history? I briefly consider six -- and

overlapping -- views of the future. In each the United States, as the leader of the international economic system, inevitably plays a central role.

One scenario is that of direct military conflict between the United States and the USSR, namely nuclear war. I include this in order to present a wide range of possibilities, no matter how horrible. It does not require lengthy discussion. If it happens, there probably will be little need to consider anybody's future. I think it extremely unlikely that Japan could escape direct or indirect devastation from a U.S.-USSR nuclear holocaust.

The second scenario is Panglossian (best of all possible worlds): reaffirmation of the open, free, market-oriented international economic order; detante or at least reduction in confrontation between the United States and the USSR; sustained and relatively good world economic growth. In other words, this is a renewal of the postwar era following the disruptions of the 1970s. For this to occur requires renewed industrial world growth without inflation, reversal of the current tide in industrial nations toward protectionism, and sustained LDC growth with increasing opening of their markets as they move to export-oriented development policies. This scenario also assumes new approaches to the problems of structural adjustment in declining industries and a solution to developing country debt problems. Essential would be successful, full incorporation of Japan into the international economic system, with mutual accommodation by Japan, Western Europe, and the United States. Increasing Japanese international leadership would probably be a requisite. It is possible that by the mid to late 1980s such a paradise will be regained, though one must be an optimist to predict it.

The scenario which today receives greater attention -- the third alternative -- is that of industrial nation retreat into protectionism, triggered by the United States and followed with great alacrity by Western Europe. There are two variants to the scenario.

One is the formation of regional preferential trading blocs, centered on Western Europe, the United States, and Japan, with the USSR continuing its own trading bloc with Eastern Europe, and China trying to develop its commercial relations with other Asian nations. Of central importance is the degree and severity of the restrictions of such regional blocs against outsiders. Another crucial issue is what would happen to the Japan-United States alliance under such circumstances. Indeed, would Japan and the United States try to form a joint bloc, or at least good working relationships between their respective blocs? Given the current American sense that the predominant threat to its own economic interests lies in the Japanese challenge, this seems unlikely since the probably justification for protectionist actions is precisely to protect the United States against that challenge.

In this scenario, what course would Japan follow? While regional blocs are a much less attractive world for Japan than a global multilateral trading system, her policymakers would probably be able to cope fairly well. The major competition among the leader nations would be for developing country participation in their respective blocs. In contrast to the colonial period, this would give substantial bargaining power to these countries, as markets and as sources of supply. Because of its limited resource endowment Japan would need the developing countries more than would United States or Western Europe, and would in turn be able to provide them with sophisticated manufactured goods and services. In

other words, Japan would continue to pursue a policy of opening its economy to labor-intensive manufactures -- but only to its bloc members. The United States and Western Europe would be more protectionist, since after all (in this scenario) they caused the breakdown of the global system for that purpose. Accordingly, Japan could be relatively less badly off than the other major nations.

A second variant of the protectionist scenario is based on sectoral protectionism. The present Multifiber Textile Agreement is one model for other international steel agreements which restrict trade in particular important products. Policy decisions in recent years in Western Europe and the United States have been on a path leading to a de facto world cartel in steel. One can readily envisage a world of international steel agreements, automobile agreements, computer agreements which set quotas or other restraints in the amount of trade among industrial nations, and with others as well. In other words, international cartelization of major industries would be used to solve their problems of structural adjustment in the advanced countries. While the economic costs to consumers would be great, it could well be a politically simpler, easier and less debilitating condition than regional bloc protectionism.

A fourth scenario is the economic isolation of Japan. The United States and Western Europe might take such a serious view of the Japanese challenge, consider the systemic differences so important (or at least claim that it is so), and view Japanese unwillingness to adjust to Western norms so strong, that specific anti-Japan trade barriers would be erected without being applied against the products of other countries.

The automobile local content legislation has this characteristic, as does discussion of a special tariff applied only to Japanese goods.

To the extent that such restrictions became pervasive and long lasting, Japanese policymakers would face extremely difficult choices. In the short run they might well give in to such pressures. However in the longer run they would have to develop an alternate strategy. That strategy would probably involve close trade relations with developing nations, including vigorous export credits and other means of developing market access in those countries, as well as providing special access for the products of those countries to the Japanese market. In other words, the economic isolation of Japan by the United States and Western Europe could lead Japan into trying to establish its own bloc. It would be more than an Asian regional bloc because the size of Japan's trade requires a global spread of trading partners. One can envisage a Japanese strategy under such (extreme) circumstances of becoming the champion of the developing world, in competition with the Caucasian-dominated old world of Western Europe and the United States.

Some have suggested that the continued emphasis upon nations and economic nationalism is becoming outdated. As an integrated world economy is coming into existence, and as trade finance, and other economic intercourse is increasingly conducted by very large, multinational corporations, a whole new set of economic alliances and relationships might be struck among these entities, superseding or bypassing governmental relationships. In this, the fifth scenario, economies are dominated by major companies which engage in oligopolistic interactions with similar entities throughout the world as part of their global strategy. while such firms might maintain strong national or ethnic identities,

they would be willing under appropriate circumstances to work with major corporations in other nations, through joint ventures, licensing arrangements, market sharing arrangements, and the like. Economic alliances will certainly be conducted by major Japanese firms with American and European counterparts, but this process is unlikely to be a substitute for a nationally-based world economic system in the foreseeable future.

A final scenario is a continuation of the trends of the past decade -- a muddling along with many persisting problems and few solutions, but no major catastrophes and no serious slide into protectionism. Industrial nation and world GNP and trade would grow slowly, unemployment and structural adjustment problems would persist. Japanese growth would not be substantially more rapid than that of the United States and Western Europe; while tensions would persist they would be contained, in part through continued Japanese use of export restraint in major products. While it is true that nations persist in muddling along, existing patterns and policies may well prove unstable in a fundamental, long-run sense. A new era is likely to emerge; the decade of transition since 1973 is unlikely to persist for two decades more.

These scenarios are a rather crude way of outlining certain prospects for the international economic system over the longer run, and the U.S.-Japan relationship within it. The do touch upon the underlying reality of the crucial role both the United States and Japan will play, and the importance of the bilateral relationship for the system as a whole. To integrate Japan successfully as one of the major leaders of the international economic system will require adjustment by all major participants, not just one.

I have no particular prediction as to the relative likelihood of each of these scenarios. My hope is that we will return to an increasingly open, growing prosperous world economic system in which both Japan and the United States play constructive leadership roles. My fear is that the United States will lead a retreat into protectionism, probably of the sectoral variety. My expectation is that we will have the open and free international system as a professed goal but that we will muddle along, with much backsliding and some aberrations. But what policy path will be pursued, not just in the United States but in Japan and elsewhere, will inevitably be substantially shaped over the course of time by the Congress and the President.

Senator MURKOWSKI. Thank you very much, Mr. Patrick.

Our last witness on the panel this morning is Mr. Mochizuki, assistant professor of political science at Yale University. We welcome you to the committee and look forward to your testimony.

STATEMENT OF MIKE M. MOCHIZUKI, ASSISTANT PROFESSOR OF POLITICAL SCIENCE, YALE UNIVERSITY, NEW HAVEN, CT

Mr. MOCHIZUKI. Thank you, Mr. Chairman. It is certainly a privilege to be asked to testify before the subcommittee. Since I am a political scientist and not an economist, I will focus my remarks on the political management of our economic relationship with Japan, rather than address the issues of substance regarding the economic relationship.

The basic argument that I would like to make is that the Japanese have been much more politically adept at managing the economic relationship with the United States than we have with managing our relationship with the Japanese. And the reason why the Japanese have been much more adept, I would argue, is because they have an institutional advantage over the United States.

Let me briefly outline three aspects of Japan's institutional advantage over the United States: First is that Japan has a bureaucratic edge over the United States, to coin a phrase developed by a couple of Japan experts. In Japan, in order to rise to the top levels of the bureaucracy you have to have a working and intimate knowledge of the American political process and of the American economy.

By contrast, there are very few officials at the higher levels of the U.S. Government who have a similar knowledge of Japan. Most of the Asianists in the Government bureaucracy tend to be China specialists and not Japan specialists. Furthermore, those who are knowledgeable about Japan tend to be scattered all across the vari-

ous ministries and various departments and agencies in the U.S. Government.

A second reason why the Japanese have an institutional advantage over the United States is that the Japanese have been able to exploit the revolving door that we have between Government and the private sector. Many of our trade officials are now working as consultants and lobbyists for Japanese firms and the Japanese Government to monitor the U.S. policy process.

By contrast, it is unthinkable to have a similar recruitment of ex-Japanese Government officials working for U.S. firms and for the U.S. Government to monitor the Japanese policy process.

And third, the Japanese have an institutional advantage over the United States because they have a well-developed organizational network to promote Japan's economic interest in the United States, whereas we lack such an organizational network. Just to give two examples of the kinds of institutions that the Japanese have in the United States: one is the Japan External Trade Organization; the other is the Japan Economic Institute.

Now, what are the implications of this institutional advantage that Japan has over the United States? This institutional advantage is not the primary cause for the trade imbalance; the only way that the trade imbalance can ultimately be rectified is for the United States to sell more goods to Japan.

Also, this institutional advantage does not mean that Japan is playing the game unfairly. The Japanese Government is only doing what a government should be doing, which is to promote its economic interests in the United States. Our problem is that we have been too complacent about our own economic power and we have left it up to private business to promote our interests in Japan.

Japan's institutional advantage is even more of a problem now because of the different tasks that Japan and the United States face. Japan now only has to preserve what it has; it just has to keep the U.S. market open. The United States has a much more difficult task. It has to promote the opening of markets in Japan and taking advantage of the markets that are already open.

Now, many of you would probably argue that the Americans cannot do what Japan does in the United States because the Japanese political process is much more closed and impenetrable to our influence, and public relations campaigns. I would disagree with that statement and argue that the Japanese political process may not be as open and transparent as the United States, but it is far from closed and opaque.

Let me just give you three basic characteristics of the Japanese political process which we could take advantage of in order to promote our interests. First is the characteristic of bureaucratic sectionalism. The Japanese bureaucracy is not a Japan, Inc., as many Japan experts before me have mentioned. But time after time, we have forgotten this universal phenomenon of bureaucracies and we forget that Japanese ministries may be in conflict over turf protection. For example, we make the mistake of responding to a feeler from MITI by going to the Ministry of Foreign Affairs.

We need to be aware that the conflicts among the ministries create opportunities for us by creating allies for our position within the bureaucracy. We have only begun to take advantage of this

conflict. For example, this year we have taken advantage of the conflict between the Education Ministry and MITI to make sure that our software would have copyright protection. We have also taken advantage of the conflict between MITI and the Ministry of Post and Telecommunications to make sure that we would have access to the value added networks as a result of the privatization of NTT.

Another thing that we should be aware of about the Japanese political process in addition to bureaucratic sectionalism is that it is not the bureaucracy that rules Japan; it is the Liberal Democratic Party which is the final arbiter on political issues, and we should recognize that there is a growing pool of Liberal Democratic Party politicians who have policy expertise.

We should identify those who are most influential on trade issues and work with them to pursue our economic interests. You will find that many of them will be quite willing to serve as a go-between between the bureacracy and the United States to press our economic interests.

Finally, we should recognize that there are Japanese supporters of the U.S. position on trade. There is an emergence of a free trade coalition composed of trading companies, big business, and consumer groups. We should mobilize those groups and support our position on trade.

We should also recognize that there are those within the government who support macroeconomic policies which will be in the interest of the United States. I am thinking in particular of two challengers to Prime Minister Nakasone who argue that Japan should take a much more expansionist fiscal policy in order to promote domestic demand. The promotion of domestic demand in Japan would promote demand for more products from the United States.

What needs to be done to redress the advantage that Japan has in terms of the institutional management of United States-Japan economic relations? Having Joint Advisory Commissions on United States-Japan Relations I think is very useful, but what we need is to supplement the work of such binational forums, with a day-to-day monitoring of United States-Japan relations and implementation of our economic objectives.

There are two things that we can do. First, in Washington we could develop a Japan Secretariat modeled after the National Security Council, which would bring together into the White House a small group of Japan experts who could coordinate a strategy vis-a-vis Japan in terms of our economic interests.

There is also a lot that can be done in Tokyo. First, we could increase the size of the commercial staff in the U.S. Embassy. Nat Thayer pointed out that Japan has 30 MITI officials and 16 Finance Ministry officials in the United States. We only have eight economic officers and six commercial officers in the U.S. Embassy in Tokyo. If we believe that the trade imbalance is a serious issue, we should more than double our staff in the U.S. Embassy.

We should also develop a semiprivate, semipublic organization in Japan that will promote the business interests of the United States in Japan by helping them market goods and by monitoring the Japanese policy process. We should establish something like the

Japan External Trade Organization in Japan, perhaps calling it the U.S. Trade Organization.

And third, we should develop an expertise among functional policy specialists in the United States by sending them to Japan for 2 to 3 years to develop an expertise in Japan. It is not good enough just to have Japanologists be involved in the trade relationship with Japan. What we need to have is a pool of functional policy specialists who are also intimately familiar with Japan.

Thank you very much.

[Mr. Mochizuki's prepared statement follows:]

PREPARED STATEMENT OF MIKE M. MOCHIZUKI

Mr. Chairman, Members of the Subcommittee:

I am honored to have this opportunity to testify before the subcommittee on the subject of U.S.-Japanese economic relations and the efforts that should be made to reduce trade frictions.

Since I am a political scientist, and not an economist, my remarks will focus on the political management of the bilateral relationship, rather than on substantive economic issues as such. I shall argue that the Japanese have been much more adept at managing the economic relationship with the United States than we have been at managing our relationship with Japan. After outlining the implications of Japan's skillfulness in dealing with the United States, I shall suggest some ways to promote more effectively American economic interests in Japan.

Japan's Institutional Advantage over the United States

One reason that Japan has been more effective in promoting its economic interests than the United States is the "bureaucratic edge" which Japan has over the United States. As Ronald A. Morse and Edward A. Olsen pointed out in a Foreign Policy article last year, the Japanese bureaucracy emphasizes the importance of understanding the American economic and political scene, and government experts on the United States are found at all levels -- from the top posts down to the working levels. In sharp contrast, few American officials with a deep knowledge of Japan hold positions of comparable influence. Most Asianists in the U.S. government tend to be China specialists, not Japan experts. Many of the Japanologists who do occupy the important posts in the U.S.

bureaucracy continue to adhere to a paternalistic mentality toward Japan which is a remnant of the occupation period. Younger officials, who are better informed about contemporary Japan and whose initial impressions of Japan were formed after the nation became an economic power and not when it was a defeated and devastated country, have yet to reach the most important posts in the American government. Furthermore, officials who are knowledgeable about Japan are dispersed across a multiplicity of departments and agencies. This dispersion undermines our ability to develop and implement a coherent and coordinated approach to Japan-related issues.

Secondly, the American "revolving door" between government and the private sector contributes to the Japanese edge over the United States. Japanese firms have been spending millions of dollars to hire American lobbyists and consultants who have worked in the U.S. government -- often as trade officials dealing with Japan. Although this money is not always well spent, it is still undeniable that these American ex-officials provide Japanese managers with privileged information about policy developments which will directly or indirectly affect their business interests. They do not actually have to affect American policy outcomes to be useful to the Japanese; they only have to distinguish between the real and unreal threats so they can adjust their behavior accordingly in order to protect their access to U.S. markets.

It is unthinkable to have a similar practice take place in Tokyo. An elite corps of career civil servants pilots the Japanese bureaucracy. Upon retirement, the bureaucrats usually work for Japanese private firms or public policy companies in fields in which

they have already worked. They are not hired by American businesses to promote their positions in the Japanese government, nor do they monitor policy developments in Tokyo for American clients.

Finally, the Japanese have over the years created and maintained effective quasi-public organizations in the United States and elsewhere to advance Japan's trade interests. The most important of these is the Japan External Trade Organization (JETRO) which has aided Japanese firms to find overseas markets for their products. Now that Japan recognizes the importance of importing more goods in order to keep foreign markets open to Japanese products, JETRO has a new mission of facilitating the flow of foreign goods into the Japanese market. In the United States, JETRO offices known as Japan Trade Centers spent more than $7 million on research and public relations activities in 1981 alone.

The Japan Economic Institute (JEI), formerly known as the U.S.-Japan Trade Council and funded by the Japanese Foreign Ministry, is another organization in the United States which has worked effectively for the Japanese. JEI has been publishing the best series of up-to-date reports on the Japanese political and economic scene and U.S.-Japanese economic relations that is available to the interested public. By providing informed analyses of current issues, JEI nas strived to prevent information about Japan in the United States from becoming unfavorably distorted.

The United States lacks a comparable organizational network in Japan. Notwithstanding its highly competent staff, the U.S. embassy in Tokyo simply lacks the manpower to do what the Japan Trade Centers in the United States have been doing. Various state

governments have opened offices in Tokyo, but the mission of many of them has been more to attract Japanese direct foreign investment into their states, than to push the marketing of U.S. products in Japan. Consequently, we are at the mercy of Japanese institutions like JETRO or the newly created Office of Trade Ombudsman to guide us through the Japanese market and government maize.

Implications of Japan's Institutional Advantage

By referring to Japan's institutional advantage over the United States, I do not wish to imply that this is the root cause of Japan's massive trade surplus with the United States. In the final analysis, rectifying the trade imbalance will require the relentless effort of individual U.S. firms to produce and sell competitive products in foreign markets. Nor does Japan's penetration into the higher reaches of America's policy process mean that Japan is an unfair player in the trading game. The Japanese government is only doing what a government should be doing: protecting and promoting the nation's economic interests abroad. America's problem is that it has been complacent for too long about its economic power. The U.S. government, therefore, has believed until recently that the promotion of American exports should be best left to the private companies themselves. We now know that this is not good enough.

Developing the institutions needed to promote U.S. economic interests in Japan is all the more imperative given the differences in the tasks before the governments of the two nations. For Japan, the primary mission is to hang on to what they already have: access

to America's market. Consequently, it is now adequate just to monitor the U.S. policy process and to determine at what point the U.S. would cease to tolerate further inroads into its markets. By accurately reading the American political scene, Japan can fine tune its export drive so as not to anger the United States into closing its door on Japanese merchandise.

But the task before the United States is much more difficult. It has to pry open Japanese markets in strategic sectors which the U.S. is competitive. This mission requires endless and frustrating hours negotiating with Japanese officials and mastering the peculiarities of Japanese procurement, licensing and distribution practices. These capabilities are often beyond the grasp of most U.S. firms except the most powerful multinational companies. It is therefore the business of government to provide the necessary assistance.

Some may, however, argue that Americans cannot do in Japan what the Japanese have done in the United States because the Japanese political process is much more closed and less permeable to outside influence than the U.S. government. This may be true in a relative sense, but this does not mean that there is an impenetrable "Japan, Incorporated." Much more can be done by the United States in Tokyo if we take the time to understand the Japanese political system and to construct the institutions necessary to deal with it.

Basic Features of the Japanese Political Process

The first fact which Japan experts usually allude to in order to explode the myth of "Japan, Incorporated" is the intense rivalry among ministries in the Japanese government. No matter how dedicated

Japanese officials may be to the national interest, their bureaucracy is not immune to the phenomenon of "turf protection." Moreover, the different agencies have differing interpretations about what is in the national interest. These obvious points, however, are often lost when we actually deal with the Japanese. For example, the United States will forget about the rivalry between the Ministry of International Trade and Industry (MITI) and the Ministry of Foreign Affairs (MFA) on trade issues and respond to an informal MITI feeler by going to the MFA. Such behavior not only will offend the Japanese, but also will prevent an early settlement of a potentially damaging problem.

The conflict among ministries may on occasion produce opportunities for creating allies for our position in the Japanese bureaucracy. We need to be ready to take advantag of such opportunities. There are also times when one ministry will want American pressure to push its position against a rival agency. But the application of such pressure has to be well-timed and well-placed to prevent jeopardizing the overall relationship. This kind of finesse, however, requires a more sensitive reading of the internal policy process in Japan than what we now have. Consequently, we often come across as heavy-handed and clumsy, rather than light-footed and effective.

Another myth about Japanese politics which is prevalent in the United States is the view that the bureaucrats rule Japan, while the politicians only reign. Nothing could be further from the truth. Because the Liberal Democratic Party (LDP) has been in power since its formation in 1955, there is now a growing number of LDP politicians with policy expertise which will match that of most bureaucrats. In

the course of a career, bureaucrats will shift from one position to another about every two years, but the LDP politician may choose to concentrate on a policy problem for more than a decade and win the respect of career officials. The politician has ultimate power over the bureaucrat because the former's support is absolutely critical for passing legislation the latter wants.

Therefore, it is now critically important to understand and monitor the policy process within the LDP and the National Diet as well as of the official bureaucracy. The substance of LDP decision-making on public policy takes place in the Policy Affairs Research Council (PARC) which is divided into over a hundred specialized subcommittees and research groups. The membership of these PARC subcommittees usually overlaps with the membership of the National Diet committees. The political process in the PARC committees is complex, but no more complex than the committee system of the U.S. Congress. In the last decade, the Japanese have become diligent Congress watchers. It is time that we become keen observers of the LDP and the Diet.

Just like in the United States, there are politicians in Japan who are more important than others in certain policy areas. What the United States needs to do is to identify those who are most influential in policy areas related to trade, to understand the positions they hold and the basis of their power, and to work with them on specific problems. They will be the ones who will push through initiatives against bureaucratic inertia and resolve conflicts between ministries.

In addition to discarding our myths about Japan, we should

recognize that there are supporters in Japan for U.S. requests to make its markets more open. Kent Calder of Princeton University has referred to the emergence of a "free-trade coalition" in Japan comprising the general trading companies, the major retailers, the largest manufacturing and business federations, and consumer groups. They would all benefit substantially from an increase in U.S. imports. The United States should foster contacts with these interests and encourage their position. If Japanese automobile firms can mobilize their dealers in the United States to oppose domestic content legislation, why cannot the United States support the free traders in Japan to make Japan more receptive to foreign goods?

Regarding macroeconomic policy, several Japanese political leaders and a number of economists have come out in favor of a more activist fiscal policy to stimulate the economy. The austerity measures followed by the current government has produced an export-led recovery from the recent recession, and the major target of this export surge has been, of course, the United States. In opposing the economic policies of the Nakasone administration, Toshio Komoto, Director-General of the Economic Planning Agency, has called for investment and income tax cuts to encourage domestic consumption. Kiichi Miyazawa, a challenger of Prime Minister Nakasone, has similarly unveiled a dramatic plan to double Japan's assets by 1995 through public works and housing projects. Both proposals if implemented would ease the pressure to export and increase spending by consumers which would in turn boost imports. Needless to say, this would be in America's interest. Although the

United States cannot dictate the macroeconomic policies which Japan should pursue, it can informally provide the necessary economic analyses to support the views of a Komoto or a Miyazawa.

Need for New Institutions

What then should be done to promote our economic interests more effectively in Tokyo?

In the past several years, one response has been to establish binational forums to discuss the issues and to alert the two nations of problems before they become too politicized. The United States-Japan Economic Relations Group of 1979-1981 and the Joint Advisory Commission on U.S.-Japan Relations which just released its report have served as excellent vehicles to make a general assessment of the relationship and to recommend specific policies to reduce conflict and encourage cooperation. Other private bilateral discussions like the Shimoda Conference and the U.S.-Japan Businessmen's Conference have also fostered mutual understanding. These exchanges need to be supplemented by improvements in our institutional capabilities to develop and implement our policies toward Japan on a day-to-day basis. In order to do this, I recommend two innovations.

First, I want to second the Morse and Olsen proposal to establish a Japan secretariat in Washington similar to the one in Australia. To quote Morse and Olsen,

> This secretariat would consist of a senior Japan specialist heading a small staff of high-quality Japanologists. They would set a government-wide Japan agenda and coordinate the efforts of appropriate agencies to handle specific Japan-related tasks and policies, much as the National Security Council currently deals with other foreign-policy matters

> by organizing interagency groups and issues networks....
> In contrast to today's confusing chains of command, this network would establish direct communication between the president's personal staff of Japan analysts -- chosen for their loyalty to his aims as well as for their expertise-- and the Japan specialists currently scattered throughout the government.

Given the importance of Japan to our economic and security interests, such a body is more than justified.

Secondly, the United States should create a U.S. Trade Organization (USTO) in Japan to supplement the work of our embassy and consulates. It should have the resources to assist U.S. businesses looking for markets or investment opportunities in Japan, to monitor the Japanese policy process, to work with the Japanese government to see that existing trade agreements are fully implemented, and to develop a public relations campaign in support of U.S. positions. USTO can be staffed by Japanese professionals familiar with their economy and political process as well as qualified Americans. The cost of such an institutional network should be no more than what Japan spends on maintaining its Japan Trade Centers in the United States. It is time we recognize that Japan is just as important to our economic interests as the United States is to Japan's.

This suggestion for creating a Japan secretariat and a U.S. Trade Organization does not at all mean that I feel our relationship with Japan is a zero-sum game. The welfare of both nations will ultimately improve as a result of more trade. Nevertheless, the current imbalance in merchandise trade needs to be mitigated or it will become politically impossible to restrain the calls for protectionism and to prevent a disastrous trade war.

Biographical Information

Mike M. Mochizuki is Assistant Professor of Political Science at Yale University. He teaches and conducts research on Japanese politics and public policy, and international relations of East Asia. After completing his Ph.D. in political science at Harvard in 1982, he was postdoctoral fellow at Harvard's Program on U.S.-Japan Relations. Mr. Mochizuki has written on Japanese security issues and is currently completing a book on the Liberal Democratic Party and the National Diet of Japan.

Senator MURKOWSKI. Thank you very much, Mr. Mochizuki.

You indicated something that is very obvious, of course, with regard to the Japanese targeting the market of the United States and using the traditional American avenues that are open, such as top industrial lobbyists or former Government officials serving as lobbyists and so forth. I am wondering if in your opinion the tradition that has existed in Japan as a result of the postwar recovery effort has been really to target the more or less open market of the United States, which has the greatest potential for Japan and the world. Less open methods and approaches have become somewhat traditional within the Japanese internal structure of business and government. And they have become very effective and very efficient in our market. We are in our traditional manner very open and we allow without reservations and without protectionism this climate to exist, because it is the American way and it is traditional. But Japan has had to establish internally, initially after the war certainly, a protectionist type of structure.

Now the teacher has become the student in some respects. The position of the United States has changed and we have seen the imbalance increase dramatically. The question is whether we can expect the Japanese traditional methods to change to allow us to penetrate their markets deeply, to allow them to recognize the significance of what we perceive to have happened as a consequence of the tremendous efficiencies and role that Japan has played in trade as a world power.

How do you see, as a student of Japan and of economics, the likelihood that Japan will make an orderly transition from what was a structured, designed effort to achieve a certain role, which I think they have achieved?

Mr. MOCHIZUKI. First let me clarify what Japan's strategy has been with the United States. I think it was a two-step strategy. First, Japan worked to take advantage of the openness of the U.S. market by developing an organization like the Japan External Trade Organization and by aiding Japanese businesses, by giving them information about the markets they could take advantage of. They have done this.

Now, their strategy is basically to preserve what they have, and that is the political side of it.

Senator MURKOWSKI. Although they really have not stopped there, to preserve what they have. Their procedures and attitudes are pretty much what they were.

Mr. MOCHIZUKI. But now the Japanese firms are very well acquainted with the U.S. market, not because we helped them but because they helped themselves.

Now, in terms of what we can do in Japan, I think it is almost preposterous that we are at the mercy of the Japanese to guide us through the Japanese market and the Japanese Government. There is a joke that the Japan External Trade Organization should be changed to the Japan Import Trade Organization, and it is strange that we have to rely upon Japanese institutions to help U.S. businesses market goods in Japan.

We should develop our own institutions to work with the Japanese institutions to promote our products. I do not think it is anything traditionally Japanese or traditionally American. It is just that we were so overly confident about our economic power that we could leave it to businesses to do this.

For an individual firm it is often too costly to do the kind of research that is necessary to penetrate the Japanese market.

Senator MURKOWSKI. Let me ask you the question, then: Do you think it is the appropriate interest of Government to do this for the private sector?

Mr. MOCHIZUKI. Yes, of course; that is the job of the U.S. Government, to promote.

Senator MURKOWSKI. You have highlighted the lack of qualified, in number at least, people in the U.S. Embassy who are familiar with—that are, first of all, in the trade area and are conversant with Japanese traditions of business and so forth. It is very hard to keep that type of an individual in the State Department in an embassy in Tokyo or Korea or wherever, when he or she can go with an American corporation and do much better.

Mr. MOCHIZUKI. Yes. But what is sad is that there are only about 20 individuals in the U.S. Embassy in Tokyo that can help businesses. Also one individual in a corporation cannot help to redress the trade imbalance. What you need is a pooling of information and a pooling of knowledge, so that all of the firms going to Japan can use that knowledge. I mean, it should be a public good, available to any American business.

Senator MURKOWSKI. Well, we have some of that capability as represented by our three former witnesses, but it is still piecemeal.

Mr. MOCHIZUKI. Yes; but when you have a bilateral merchandise trade which is over $60 billion, to have a force of less than 20 in Japan I think is preposterous.

Senator MURKOWSKI. Mr. Patrick, you indicated that the yen-dollar exchange rate was not conducive to purchases in the United States by Japan. And then you indicated that the key in your opinion was the U.S. budget deficit.

Let me walk you through an analysis that I do not necessarily agree with, but one that is talked about to some extent. I would appreciate your comments. As a consequence of that budget deficit, one can at least theorize that it is responsible to some extent for the higher interest rates that exist in this country.

But by the same token, these higher interest rates attract a substantial amount of foreign investment, because money, like water, rises to the highest level and the least risk. So as a consequence, a good deal of it is coming into the United States.

If we were to substantially reduce the deficit, we would theoretically reduce interest rates, which could possibly lead to an outflow of dollars and the ramifications could be quite severe. So if you have a shortage of dollars in this country, you run interest rates back up again, because then somebody wants the money bad enough to pay more for it and the interest rates go up according to the law of supply and demand.

While I do not disagree with your statement, I am, just like a lot of other people, confused as to how we can be certain that lowering the budget deficit is going to be the cure-all to lowering the value of the American dollar, which would certainly enhance trade and commerce and make U.S. exports more attractive.

Now, I also feel that to some degree the exchange rate problem is offered up as an ideal excuse for the reason that we have this growing imbalance.

Mr. PATRICK. We have to separate the gross inflows and outflows of capital from the net flows. The net inflow of capital from the rest of the world to the United States is very substantial; it is going to be almost $100 billion this year.

Almost half our budget deficit is being financed on that net basis by foreign savings. It is just equal to the deficit that we have on our current account of trade in goods and services on a net capital inflow basis. When we get our dollar to a more proper, lower value so that our exports become competitive and so that imports are less attractive, we will have a turnaround on the trade side. That adjustment will be equivalent on a net basis to a dollar outflow or the net reduction in the foreign inflows into this country.

The dilemma is that of the timing of the adjustment process. If it should turn out that suddenly everyone in the world perceives that the dollar is overvalued and everybody tries to rush out of the dollar, we would see the dollar drop in value precipitously.

Now, in some ways, that would be good for our trade side. That would really help solve our balance of payments problems a great deal. But it could lead to a lot of anxiety on the financial market side.

My own feeling is that we are at the mercy of financial market expectations, private expectations about the value of the dollar. When those expectations change—and I think they will change at some point—we are going to have some substantial movement in the exchange rate. I am not sure that we have it within our power to orchestrate those changes in market forces.

Fundamentally, we want to reduce the net flow of capital into this country, because we want to improve our trade and current account situation. We want to export more and to import less. The reduction in interest rates will be the mechanism to make it less attractive to attract capital here, will make it less necessary to do so, and will therefore lead to a new exchange rate that will be more conducive to promoting our own trade interests. And we do not have that now.

Senator MURKOWSKI. I agree with you, the bottom line being that any effort to reduce interest rates will stimulate both trade and internal economic activity in our country.

Mr. PATRICK. That is right.

Senator MURKOWSKI. Another point that you mentioned that I thought was very interesting is that we spend too much time on the insignificant items, not that they are insignificant in their makeup, but as far as making a big impact on the deficit, they will not.

Have you any recommendations for the administration in negotiating trade policy or for the legislative branch to try and define some specific areas where we can turn to some big ticket items that will responsibly turn the trend? And I am not suggesting a zero balance by any means, but I am suggesting the need for something that is meaningful, large enough to bring that deficit down, so that we are satisfied that there is a good faith effort being made, as opposed to the general view by many of my colleagues that the Japanese are really not being responsive. If we could do that, we would see it increasing at a lesser rate or beginning to actually decrease.

Mr. PATRICK. I think we have two problems. One is the problem of ignorance as to what is doable in Japan, and that is a problem of lack of real careful study of how we can implement a negotiated set of policies. For instance, I think we started off on our capital liberalization efforts late last fall really thinking that was going to change the yen-dollar exchange rate, and that was pretty naive.

I think it was important that we push for capital liberalization, but for other reasons. It is in our long-run interest, but it was not going to be the quick fix that we might have deluded ourselves with initially. And if we had studied it more carefully, perhaps we would have recognized that.

The other problem, frankly, is that we do not know how to reconcile in our society our domestic political interests and our international economic interests, and as far as I can see our dilemma in trying to get our economic agenda put together in dealing with Japan is that our priorities are set by political criteria, rather than economic national interest criteria, so that we spend a lot of time on something in which a domestic constituency that happens to be politically powerful—such as the orange industry—gets onto the agenda, and we do not get onto the agenda certain other items that should be on there, or we do not get them on soon enough.

Cigarettes is a much bigger ticket item than oranges, but it took years to get that onto our agenda, and finally we got it and we are starting to get some action.

The defense issue really runs up against Japanese sensitivities about wanting to have their own defense industry. I think, as this new report by the way stresses, the United States could sell the Japanese certain military equipment at a much lower price than they can to produce it for themselves. However that runs up against the a whole Pentagon defense arrangement with Japan which encourages the Japanese to engage in defense activities, and seems to be that the quid pro quo is Japanese production rather than purchase from the United States.

As you know, there is no economic justification for restricting the export of Alaskan oil to Japan, but there are strong political restrictions. Part of our problem is not simply having a coherent administration policy, but being able to pull it all together given the divergence of our political interests.

And certainly we are not helped by having many different vehicles for pushing different exports: oranges by Agriculture or some other export good depending upon the department. I think it is very important that we have an interagency group, which we now have serving under the Secretary of State, as I understand it, to coordinate policy.

And we need to have that coordination of policy. I suppose it is hoped that this newly proposed Department of International Trade would be able to provide that kind of coordination. Given the pluralism of our system, I cannot be particularly optimistic that we will pull that off.

Senator MURKOWSKI. That brings up the question of the formation of the Department of International Trade and Industry as a means of reconciling the domestic and political interests and international economic interests.

My question is, for this to work—and again, as Secretary Olmer said, it is in the eye of the beholder. But at least for the sake of our discussion, that would mean Commerce, State, and the Special Trade Representative giving up something, establishing some degree of accountability and restructuring ways to determine policy. Ordinarily you would develop a plan over a period of time that would lead you to certain objectives and steps and initiate your negotiation.

Do you think that this particular effort to formulate this Department of Trade and Industry has a chance within our system to address the goals both of us have laid out? Not that we have had that much of an opportunity to compare notes.

Mr. PATRICK. I guess I support that legislation, since I think it provides an opportunity. At least we should give it an opportunity, mainly because it brings to our attention the increasing salience of foreign trade and foreign economic relations for our domestic economy, because that has become the new reality of the world.

For a long time, we could afford to think that this was not only the biggest market, but the only market. We no longer can do that, and we have to find new institutional mechanisms to make foreign trade policy more salient in our total domestic policy and our total foreign policy.

And I suppose a new Cabinet position and a new department is as effective a way of trying to do that as any. I am not particularly hopeful that a new phalanx of Government bureaucrats will solve these problems. But maybe pulling these diverse elements into one organization will move it forward in some respect.

Senator MURKOWSKI. Let me ask all of you: In the event that the trade imbalance does indeed next year reach $45 billion, and the projection for the next year is then $55 to $60 billion, which is not beyond the realm of possibility, what do you think we should do? Not just about the problem, but to initiate a corrective response from the Japanese, recognizing that we have in place specific things that do occur, specific progress that is being made, but still it is increasing at an extraordinary rate when you consider where it was this last year of $19 to $21 billion?

Mr. MOCHIZUKI. I do not think there is going to be any quick fix for this, because this trend is something which has a long history. Whatever organizations are developed or what negotiations may be

made, they are only going to make a small dent into this trade imbalance in the short run.

But it has to be seen in the long term. What needs to be done in the mean time is to maintain the free trading regime. A single effort to open up $500 million of the Japanese market may not make a dent in the trade deficit, but when you keep adding up those $500 millions, it soon becomes real money. And so that is what needs to be done.

Senator MURKOWSKI. Be a little more explicit. Those things are already available to us. Those things are working. The deficit is increasing, and when is enough enough? How do you develop an attention-getter?

Mr. MOCHIZUKI. I think it has to be made clear to businesses that they have to think export-minded, and when they do think export-minded, the U.S. Government should help these businesses so they do not get discouraged about the Japanese market. And at this point there is very little help from the U.S. Government to do that.

Also, I think, although the creation of a DOTI might be good, I do not think that is good enough. Such an institutional innovation is just staying in step with the Japanese, and I think that the Japanese are beginning to realize that having a MITI is not good enough, because you still have the interagency rivalries such as among MITI, the Ministry of Finance, the Ministry of Agriculture, et cetera.

I think the only way that you can get one step ahead of the Japanese is to put something visible in the White House which would coordinate Japan strategy, and I think with that kind of innovation the Japanese would realize that we mean business. Until we do that I think we will still just be reshuffling bureaucracies and not make any progress.

Senator MURKOWSKI. Mr. Thayer?

Mr. THAYER. I think the trade imbalance will correct itself. The Japanese are beginning now to start investing in this country. Some of the money the Japanese took out of the United States in trade is coming back in investments.

Senator MURKOWSKI. I am sorry, I did not hear your first remark.

Mr. THAYER. The trade imbalance is self-corrective. Money sent abroad to pay for trade goods is coming back through investment.

Second, American business is going onshore in Japan. Just this summer, for example, IBM announced that it is establishing offices in Japan employing better than 300 engineers, American engineers. The Japanese semiconductor industry is more than a little bit worried.

Let me change the subject slightly and talk about creating new institutions to deal with international trade. Before we create a Department of Trade and Industry, I would like to know what we are going to do with State, the USTR, and with Commerce, and with what is coming to be another major trade department—the Department of Defense.

We already have a major problem in coordinating policy and actions among these agencies. That problem will not be solved by creating another agency.

However, I am more concerned with the individuals than I am with the institutions. The fellows who can conduct diplomacy in Japan are very, very few and are not training replacements. Even recognized Japan experts within the Government can only serve, out of a 30-year career, about 10 years in Japan, and that service is discontinuous. Very few of them have—as I have stated in my testimony, the language ability to speak and read Japanese, much less write it. The Foreign Ministry in Japan is no longer in command of foreign affairs. Other agencies have a piece of the action. Knowing where to go and whom to persuade, what is best done by the government and what is best left to private heads, knowing what arguments will prove effective with which ministry—this knowledge is essential for the correct conduct of diplomacy with Japan.

Journalists in Washington like to write about the lobbyists who work for the Japanese. If you check into the records in the Department of Justice, you will find that better than 200 people are registered as lobbyists for various Japanese interests in this country.

That is an interesting story. A more interesting story is that there is not one American lobbyist in Tokyo, and they have to come into being.

Senator MURKOWSKI. I understand there are very few attorneys in Tokyo in comparison to here.

Mr. THAYER. Yes, that is true.

Senator MURKOWSKI. That would be an interesting study or even an interesting hearing, but that is for another day.

Mr. PATRICK. Could I respond also?

Senator MURKOWSKI. You may, Mr. Patrick.

Mr. PATRICK. The $45 billion trade imbalance number we have to treat with care. Mr. Olmer corrected himself and said that was only for the manufacturing component of the trade imbalance. The United States runs about a $10 billion surplus on agricultural and other natural resource products. So that he is talking about a projected bilateral deficit, I gathered, of around $35 billion for the coming year.

A lot depends upon what happens both in the American economy and the Japanese economy. The Japanese economy is growing faster than was projected, which is good for our exports. A lot will depend upon what happens to the exchange rate. Frankly, I think it is inconceivable that we would have a bilateral trade deficit with Japan of up to $50 or $60 billion in the next 2 or 3 years. That would be symptomatic——

Senator MURKOWSKI. Why do you say that that is inconceivable?

Mr. PATRICK. Because I think it would be symptomatic of a far larger overall global U.S. current account deficit way above $100 billion, and I do not think that is likely to occur, because there would be, in the first place, market forces that were corrective. At some point, the dollar value would go down in foreign exchange markets when the current account deficit went too far.

Or if that did not occur, I think the U.S. Congress would say: A $150 billion current account deficit is not tolerable and we are going to take some actions. For both those reasons you would find something happening to prevent such an imbalance.

I have heard it said that the Congress will only act when it gets to an extreme brink, and I think a $150 billion current account deficit would be an extreme brink.

Senator MURKOWSKI. I hope you are right, and I hope that in 2 years you and I will have an opportunity to pursue this conversation and that I can indeed comment on your prophecies.

I have not been here very long, but when I first came in a number of my colleagues claimed that we would never, never see our accumulated debt exceed a trillion dollars. Well, it has exceeded a trillion and a half dollars, and I have been here for 4 years. So I am continually amazed at what Government will tolerate.

I understand that you have a plane to catch, so you may feel free to leave at your convenience.

There was a comment made, Dr. Thayer, by you that I think bears closer scrutiny. My concern is this trade imbalance is not going to go away. You referred to Japan becoming a substantial world exporter of capital which strikes me as a maturity of substance within the economy that Japan has achieved through its efficiencies.

The question of where this takes Japan really sees no conclusion, in the sense that once you start exporting capital, you bring back the revenues or a portion of them after reinvesting within whatever internal structure or external structure is available to you from the standpoint of a return on investment.

But there is the implication that, at least theoretically, this enriches the country. And we saw this—I guess an example might be Great Britain in her period of glory. And then there is always the erosion that may occur under any given set of circumstances, of not being able to manage this.

But Japan certainly appears to be on the upswing, accumulating substantial capital and going out and investing it in the world, and then bringing it back and reinvesting it, which I do not think necessarily correlates with any reduction in the deficit balance of payments because it implies more of the same with greater efficiency and greater power and greater commitment.

And I think your point is very well made, that it is something that we are seeing. I am interested in the effect of this in regard to our trade with Japan.

Mr. THAYER. The Japanese Economic Planning Agency report, calling for Japan to become a capital exporting nation and the Cabinet decision to accept this recommendation was made just this past summer.

It is a little early to know what this decision is going to come to mean. But that the Japanese are beginning to move out, play a more active world role—that is true. You can see signs everywhere. The present Prime Minister, who is the most aggressive——

Senator MURKOWSKI. Could you speak into the microphone, please.

Mr. THAYER. The Japanese are in the midst of a debate over where they are going and what they should be doing in their policies toward the outside world. It is too early, really, to say precisely where they are going. The debate has to go further.

One of the men who is the most active, though, in pushing Japan into a greater world role is the current Prime Minister. What hap-

pens if he goes? I think his reelection this fall is pretty clear. But party rules say he must leave office in November 1986. What will be the position of the new men who will succeed him? Will they want to be as aggressive in moving out into the world?

This question is open, no answer can be given yet. Some Japanese emphasize that moving out into the world entails responsibilities. Other Japanese emphasize opportunities.

A major item on the Japanese foreign affairs agenda is the American trade imbalance. This summer, the Japanese Ambassador to the United States went back to the Tokyo report. The first statement he made on getting off the plane—it made a front page story—was: Japan must worry about the trade imbalance with the United States. There is no lack of consideration of this trade imbalance with the United States. But the Japanese don't know what to do next.

Senator MURKOWSKI. Well, the simple answer is, Japan should buy more from the United States, because Japan, as we all know, is a country that is dependent—and I think it was evidenced in your comments—on energy and natural resources being imported into that country. And the question is an obvious one.

The reason they do not is they can buy it cheaper from some other country than they can from the United States. And then you go back to a business principle, that what do you do with your best customer, meaning the United States being the best customer of Japan? Well, you take good care of it. And how do you do that? Sometimes you are willing to pay a little bit more rather than pursue other alternatives.

I do not know that we can bring the relationship down to that rather basic analysis, but I think there is some application, certainly, of principle here, because those are the facts of where we are and what our relationship has come to.

Let me ask you this, gentlemen. There have been discussions from time to time regarding a tax on imports. I believe in 1971 President Nixon imposed an import surcharge. That is a very drastic extreme, but it certainly catches the attention of the beholder.

I am wondering if you feel it is not necessary, but would this be an appropriate consideration for Congress; if indeed there is not some substantive and visible efforts by the Japanese that we can see in the trade imbalance being turned around, that something like this extreme might be necessary?

Mr. PATRICK. I think that would be a very inappropriate act and a very dangerous one: inappropriate because we have a free exchange rate system, fluctuating exchange rates, so that if you impose a tax surcharge you are going to get some compensating adjustment for the exchange rate.

Now, what might happen would be that the United States would import less from Japan and Japan would export more to other countries. But those countries might end up exporting more to the United States. We might reduce the deficit with Japan, but increase our deficit with others.

So there is no assurance that we would solve our basic economic problems or political problems in that way, and indeed, we would create very severe political problems, because, instead of integrating Japan into the international economic system and asked for its

leadership, we would have isolated Japan from the international economic system and would have said, we are not interested in you being a good partner and we are not interested in being a good partner with you.

And I think that is a very dangerous signal in the long run if you want to have a truly good, close partner relationship.

Senator MURKOWSKI. Does anyone else care to comment?

Mr. MOCHIZUKI. I would wholeheartedly agree with Mr. Patrick's assessment. I think we should not focus on the trade imbalance as such, but rather think, about when the trade imbalance will become politically intolerable. I think at this point it is more politically tolerable than at other times, because the domestic economy is functioning much better than it has in the past. And so I think what is important is that we do not do anything just to redress the trade imbalance.

Senator MURKOWSKI. OK. I do not disagree. I appreciate your comment.

Mr. Thayer, you can respond to the question as well. But when you respond, I would like you to take into consideration one other rather basic reality, and that is, while we know the answer is simply to have Japan buy more from us, we face the reality that Japan can buy cheaper from many other countries, for many obvious reasons, whether it be our environmental protection laws that dictate additional costs associated with what we produce, whether it be pulp or any other product, or the requirements that we have in our coal mines, such as the various safety measures, and all types of things which are very basic and cost money.

We cannot provide Japan with the raw resources that Japan needs as cheaply as Japan can buy them someplace else. Now, those are facts. So again, how do you get there from here?

You could say, well, we need more expertise in our efforts, we need more and better methods to encourage and pave the way for American businesses to go into Japan. These things are all true, but you have a basic underlying reality associated with the costs of where Japan gets its resources.

I think Dr. Thayer or Mr. Patrick indicated we spend too much time with these smaller items that are significant, but do not affect the big tickets. And again, I would ask you, if these are realities of cost, how do we do it, unless Japan is willing to accommodate us and pay more to maintain the best customer relationship and not allow the Congress of the United States to come in and initiate poorly thought out protectionist measures?

Mr. MOCHIZUKI. But you have to understand, it is not just a matter of the Japanese being willing to buy more, but the willingness of Americans to sell more.

Senator MURKOWSKI. I think that is a foregone conclusion. I could fill this room with the coal industry who wants to sell more coal.

Mr. MOCHIZUKI. If you are talking about raw materials, in recent history it has not been the case. What the Japanese are interested in is not just cost, but a stable supply.

Senator MURKOWSKI. Let us look at coal. Why is Japan buying less coal from the United States?

Mr. MOCHIZUKI. Because in the early seventies we got rid of our long-term contracts for selling coal.

Senator MURKOWSKI. Why did not Japan renew those contracts with the Western coal operators?

Mr. MOCHIZUKI. Well, it is time that we reflect on what we did in the past and negotiate for long-term contracts.

Senator MURKOWSKI. Well, we would like to.

Mr. MOCHIZUKI. Well, we ought to.

Senator MURKOWSKI. Japan does not want to enter into long-term coal contracts with the United States because they can buy the coal cheaper from South Africa, they can buy the coal cheaper from Australia. Why buy it from the United States?

Mr. MOCHIZUKI. But I think if we emphasized that we would be a stable supplier——

Senator MURKOWSKI. We have done that. We have done that in many areas of energy, and we are a more stable supplier. But let us be realistic. If you are in business, you are in business for a return. You are going to buy the resource where you can get it the cheapest. And Japan is not unlike any other business person, and that is the hard core reality.

Now, we can philosophize on different things that we can do. But I ask you, if you are talking about a significant dollar item, how you can react and play the ball game if you cannot compete pricewise?

Mr. MOCHIZUKI. Yes; and who have you talked to in Japan to sell more coal or to sell more Alaskan oil? I mean, you have probably talked to the ministries. I do not think that that is good enough, because I think the only people that can arm-twist the ministries into doing this and serve as a broker between the ministries and the private sector are the politicians. And I do not think the United States has used influential politicians enough to do this.

Senator MURKOWSKI. Well, we used the President last year, and I do not know what more we can do.

Mr. MOCHIZUKI. No; I mean politicians in Japan.

Senator MURKOWSKI. We have the Energy Study Group and there were meetings in Japan and there were meetings here, and we get one thing. We get an agreement on a prefeasibility study on a coal operation.

Mr. MOCHIZUKI. But who are you talking to? Bureaucrats.

Senator MURKOWSKI. I know, but you start with the President and you start with Premier Nakasone. They dictate down to a level and you put the business, the private sector, together and they make many trips and they come back with a prefeasibility study.

Now, is that anything significant or concrete about selling a resource?

Mr. MOCHIZUKI. But as you know, even with the United States, when the President says something that does not necessarily mean that everything falls into place. I think more has to be done.

Senator MURKOWSKI. I could not agree with you more. I am just trying to find that out.

Mr. Thayer?

Mr. THAYER. The Japanese do not always buy at the cheapest price. They would like to, but they are not always successful. They often buy from properties in which they——

Senator MURKOWSKI. Please speak into the mike.

Mr. THAYER. The Japanese do not always buy at the cheapest price. They would like to, but they are not always successful. One instance when they do not buy at the cheapest price is when they buy raw materials that they themselves have developed overseas.

Indonesia is a case in point. Australia is another. Many of the mines in those two countries are mines that the Japanese have developed. They have a substantial capital investment. To protect that investment they are going to use those mines whether or not they produce the cheapest ore or not.

Senator MURKOWSKI. I understand. And this is my point, though.

Mr. THAYER. Let me just finish my point. The United States has many resources which are not developed. The East Asian nations—Japan, South Korea, and Taiwan—have need for resources and are actively planning how to acquire them. This planning is often done—in part if not wholly—by the concerned governments.

The United States should be more aware of, if not actively participating in these plans, trying to match up its undeveloped sources with the East Asian countries' needs. For example, a Japanese semigovernment body is studying Japan's need for strategic minerals. Are we contributing our views to this body or not? Well, we have not done so, so far.

Senator Murkowski. The frustration that I think is apparent is when we see the actions of Japan in pursuing gas from Sakhalin and oil, at the same time when they are increasing their defensive capabilities, for many reasons, and dealing with the Soviets on the one hand, when the matter of the Northern Islands has not ever been resolved.

And we look at it this way: Gee, why on the one hand are you doing business as usual, and you still have not, I believe, negotiated a peace treaty? These are things that I think frustrate many of us here. We have seen commitments to purchase coal from the Soviets. I believe in November there was a contract of about 3 million tons. I cannot recall the figure, but a substantial amount, over a 4-year term.

You mentioned, Dr. Thayer, my point: Export capital out of Japan, and we are seeing it, I am told, in China, where Japan has advanced funds for investment in Chinese coal production, and then turned around to ensure that their loan repayments will be met by the coal. And there is nothing wrong with that philosophy, but it still represents, I think, a continuation of increasing trade deficits.

I am not going to spend much longer. There are a few questions for the record that I am going to ask in conclusion, if I may, that I think should be addressed. And the first one, and either one of you can answer: What do you see as the prospects for change in the dollar-yen rate, and do you expect to see a gradual strengthening of the yen as the Japanese implement their plans for making the yen a more international currency?

Mr. THAYER. My answer is very simple. We have been talking about the dollar-yen exchange rate for the last 2 years. Every prediction on it has been wrong.

Senator MURKOWSKI. Some analysts attribute the huge deficit this year, at least partially, to a stronger economic recovery in the

United States than in Japan. Do you feel the Japanese economy is lagging? Or is it just a situation where it has little relevance, which is what I think?

Mr. THAYER. Again, the facts are correct. The Japanese comeback is not as strong as the American comeback yet. But the American comeback has been very strong. There is perhaps a lag effect.

Mr. MOCHIZUKI. I think the reason for that is that Japan has pursued an austere macroeconomic policy and therefore most of the growth has come out of exports rather than a stimulation of domestic demand. And I think experts in Japan disagree whether the austerity measures should be continued or whether Japan should move toward an expansionist fiscal policy.

Senator MURKOWSKI. The United States-Japan Advisory Commission report to the President recommended that a joint United States-Japan feasibility study for marketing potential of Alaskan North Slope gas should be undertaken expeditiously. Do you have any reason to be optimistic about this report, or do you have any information on when the recommendations might be implemented?

Mr. MOCHIZUKI. I do not.

Mr. THAYER. I have no information on that.

Senator MURKOWSKI. One other question with regard to internal Japanese affairs. What is your evaluation of MITI and its current role? The point has been brought out that we have seen other agencies overlapping in the area of responsibility, whether it be the agricultural ministry or various others.

But do you see MITI changing with the demands? Does MITI have the flexibility, or is it too steeped in the traditional plan that led to Japan's successful recovery effort to be responsive to change? How do you evaluate MITI's role currently in Japan, Mr. Thayer?

Mr. THAYER. That is a hard question. Clearly, MITI does not have the power today that it had during, say, earlier on, in the fifties and sixties. It is trying to work out a new role for itself in Japan today, and that role is not yet set.

MITI, incidentally, does not do one thing; it does lots of things, and some of the things it does better than others. But it no longer directs the Japanese economy, if, indeed it ever did. It is disengaging itself from that role.

Mr. MOCHIZUKI. In terms of MITI, I believe that MITI has moved much more in the direction of free trade.

Senator MURKOWSKI. More in the what?

Mr. MOCHIZUKI. In the direction of free trade, than in the past. And I think that on many issues you will find MITI to be on our side as far as opening markets.

The other thing is that I think MITI has less power over strategic industries, because these industries are now strong enough to compete internationally. I think the major mission of MITI now is to ease the structural adjustment costs for the declining sectors in Japan that are becoming less and less competitive at the international level.

Senator MURKOWSKI. If you were going to put your finger on where the problem is in Japan with regard to their apparent inability to give us a responsive sign of intent to respond on the balance of payments deficit, where would you direct it?

Mr. MOCHIZUKI. I think one is bureaucratic inertia. I think that many of the political leaders do not realize the persistence of certain barriers, and they were surprised when they looked.

And the other is the lack of efforts on the part of the United States to really push exports and to think in terms of exports.

Senator MURKOWSKI. Well, if we do not have avenues to come into the country with our exports—and it is better than it was—is that not a significant deterrent in itself, which implies that you cannot really come in and do business? You say encourage American investment and business to come in, but if the roadblocks are such then the private sector can only do so much before it has to turn to Government.

Mr. MOCHIZUKI. Well, it is partly roadblocks, but it is partly figuring out what kind of products the Japanese are willing to buy. And I do not think we do enough of that.

Senator MURKOWSKI. Where would you put your attention, Dr. Thayer, if you were going to identify the areas where we ought to try to look for relief?

Mr. THAYER. U.S. officials have been content to stand back a fair distance and to holler at the Japanese. The Japanese bureaucracy which is charged with listening to us, does listen to us. It tries to do what it can do. But—there is not one place in Japan where policy is made. It is very much like the United States; policy is made in dozens of different places. Furthermore, policy is, often an accumulation of many small decisions rather than of one major decision.

I think U.S. officials have to acquire a greater understanding of how the Japanese Government works. So far, they have seen the ministries as all-powerful. The area where I would look is not to the ministries. The ministries are not as strong as they are thought to be. The place where I would look is within the Policy Council of the Liberal Democratic Party itself.

Within the Policy Council are committees, one to oversee each ministry, usually to cover problems not handled by the ministries. These committees meet regularly. Usually they convene at 8 o'clock and go on until late morning.

To date, American officials have not paid attention to ruling party deliberations outside of debate between parties in the Diet. They should. Real decisions are made in party. At best, Diet debate only modifies these party decisions. Such coverage will require restructuring the embassy and recruiting Foreign Service officers who can deal with Japanese politicians in Japanese, finding ways to honor their concerns and defend American interests.

Senator MURKOWSKI. Well, let us look at the responsibility of government. First of all, it is to serve and provide for the protection of the people and to enhance the climate necessary for the betterment of the people that make up that government.

So are we not—and could not one make the argument that we are not serving our own self-interest? And at what point do the United States and Japan begin to accommodate each other's individual interests, which is what trade relations and international commerce and diplomatic discussions are all about?

It is a matter of give and take, because there is no ideal resolution. There cannot be. It is a situation where each side justifies its

own particular point of view by the inequities that may exist at that time or in the eyes, as Mr. Olmer said earlier, of the beholder.

The message that I am going to leave you with from this hearing, at least at this point, is: One, that neither our Government nor the Japanese Government can afford to be complacent about this ever-mounting trade imbalance. As you know and may share with my colleagues, some feel very strongly about the issue of the trade imbalance because it is perceived in their areas as a very simple issue of loss of American jobs, and these jobs are related in their minds to Japanese imports coming into the United States. They are not complacent about it.

The politicians make the argument that if we could offset a $30 billion deficit balance of trade by increasing purchases by Japan in the United States $5 to $10 billion, it would have a tremendous economic impact on our economy, and it certainly would. We are continually confronted with concern that American exporters have a difficult time breaking into the Japanese markets.

So we have a situation where the American perception, I think it is fair to state, is one of less than complacency, and as a consequence of that the U.S. Congress is not going to be complacent on the issue. I am afraid, gentlemen and ladies, that if there are no good solutions then there will be only bad solutions. And I think from the testimony taken today, we have highlighted the problem. Obviously the answers are not going to come easy.

I think the response of Ambassador Mansfield, who said that the United States-Japan relationship is probably the most important in the world bar none, is one that I would certainly agree with. But political will and the imagination of both sides are going to be needed to address the trade problem.

We are going to have to seek responsive and realistic solutions which will preserve and protect our relationship, and I think it is a partnership which has served not only ourselves, but the entire East Asian region of the world as well.

So I would suggest that, while some may see this as problems, we really have some extraordinary opportunities to pursue. And I would hope that the extremists on both sides do not prevail, and that there is a realistic commitment to understand the transition that both our countries have gone through, and where a matter of trade imbalance leaves us as we evaluate our trade relations today.

We will resume the hearing at 2 p.m. with three witnesses, and the subject will be "Can Coal Help Bridge the Gap?" We have bounced around a little bit today. This afternoon we have witnesses who are most informative on the subject of coal exports: Senator Simpson from Wyoming; Michael McCoy, international vice president, international coal, with Getty; and Miss Connie Holmes, executive director of Coal Exporters.

I want to thank you gentlemen. I wish you a good day and we will see you this afternoon.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

The subcommittee met, pursuant to notice, at 2:15 p.m., in room SD-419, Dirksen Senate Office Building, Hon. Frank H. Murkowski (chairman of the subcommittee) presiding.

Present: Senator Murkowski.

Senator MURKOWSKI. We will reconvene the Subcommittee on Pacific and East Asian Affairs, focusing on the overall United States-Japan economic relationship and trade imbalance. One of the witnesses that was scheduled to appear this afternoon, Senator Simpson, has been detained with the immigration issue. I am told that Senator Warner will be appearing.

I would like to call Mr. Michael McCoy and Ms. Connie Holmes to the witness table at this time and alert you that we may very well have to interrupt your presentation if Senator Warner comes in. I ordinarily would not do that, but because of the likelihood of a number of votes this afternoon, I am going to have to make every effort to accommodate his schedule, and I trust that you will bear with us. I apologize for the inconvenience, but I assure you it is not meant to be an oversight or discourtesy.

The hearings of the Subcommittee on East Asian Affairs this morning focused on the overall United States-Japan economic relationship. We are going to now turn to a discussion of the relationship with specific emphasis on the trade in coal between the two countries. You might wonder why we singled out coal. I guess the reasons were two- or threefold. The infrastructure is already established for the most part. The railroads are in, the port facilities, while perhaps needing some improvement, have been established. The coal is available at various ports in the United States, and the mines are developed, thus it seemed like a reasonable place to start as opposed to some other areas.

If we pursue oil we confront the congressional ban, or if we pursue gas, we must face the reality that the infrastructure has not been established in the sense of how you move gas, how you liquefy it, and how you build the tankers.

In any event, these hearings are a precursor to others we will hold at a later date to discuss other industry specific opportunities and problems. In such hearings I would hope to be able to cover trade and services and high tech, and perhaps timber and wood fibers and other issues of concern to the committee. So these other areas are not being overlooked. They are simply being put aside until appropriate, timely attention can be given to them.

The title of this afternoon's hearings is "Can Coal Help Bridge the Gap?" I think the title speaks for itself. To make a dent in the huge trade deficit we have with Japan, we must export commodities of high value and export these in quantity. We must also export commodities that are not indigenous to Japan. Coal is such a commodity.

I have had an opportunity to meet on numerous occasions with Ambassador Mansfield on this subject. I was told at one meeting that if Japan were to totally lift all of its import restrictions on citrus fruits and beef, that that amount would impact the bilateral trade deficit between $500 million and $1 billion over a 5-year period. I mentioned that this morning, and I mention it again to

put into perspective the magnitude of the $30 billion trade deficit, and the realization of the fact that we have to talk about significant, big ticket export items such as coal.

I personally support the opening of Japan's agricultural markets to U.S. exporters who, after all, are a mainstay of this economy. But again, I think the focus has to be on items of far greater potential for paring down the long-term deficit, a deficit which has resulted in an escalation of protectionist sentiment and certainly economic friction between the United States and Japan.

I look forward to hearing from our witnesses this afternoon. I know they will be presenting to the committee a review of the commercial and political problems they have encountered in their attempts to promote coal sales into Japan.

I should note that in some cases it has not been a question of trying to sell more coal to Japan but rather of trying to maintain a historical market share that in recent years has shifted to producers from Australia, Canada, South Africa, China, and yes, even the Soviet Union, all at a time when coal purchases from the United States are in decline, a noticeable decline.

As I mentioned earlier, Senator Simpson is unable to be here, but has requested that his statement be made a part of the record. Without objection it will be inserted at this point, as well as a statement by the Shell Oil Co.

[Senator Simpson's prepared statement follows:]

PREPARED STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING

Mr. Chairman, thank you for extending me an invitation to appear before the subcommittee today. I appreciate this opportunity to present my views on our current state of bilateral trade with the Japanese. Indeed, it is an issue that many of my own constituents find to be increasingly frustrating.

In my time here in the Senate, I have consistently supported the concept of free trade. I do that for many reasons—some very selfish—for the United States is the world's largest trading Nation. In 1983 the combined export-import trade was $437 billion. And my own State of Wyoming is a land ripe with export products. We produce beef, wheat, feed grains, soybeans, soda ash, and coal. We have those products in abundance and it is to our advantage—as well as to the advantage of our trading partners—to have an open international trading system. But we do not live in such a perfect world. We must face the realities of the times—and those realities point to trouble ahead in our bilateral trade with the Japanese.

Over the 1976 to 1983 period, the United States incurred a cumulative merchandise trade deficit with Japan of $92 billion. That deficit has been increasing steadily in recent years and is now running at an annual rate in excess of $30 billion. That's one-third of the accumulated deficit for the past 8 years!

On April 7, 1984, Japan agreed to increase its beef import quotas and fresh orange quotas in increments over the next 4 years. I was very pleased to see improvement in that situation, but I continue to support the U.S. negotiator's position for complete eradication of all quotas on imports to Japan. That is indeed a step in the right direction but the dollar value of this gradual increase of an average 6,900 tons of U.S. beef and 11,000 tons of oranges annually will do very little to make any significant change in that deficit—for their combined value is estimated to be $400 million over the 4-year period.

But despite continuing problems over import restrictions on American agricultural exports, Japan remains the No. 1 purchaser of U.S. farm commodities. Japan is also the world's No. 1 purchaser of U.S. coal—but that situation is deteriorating rather than improving. The U.S. coal exports to Japan have been decreasing since 1981. I was pleased to note the joint energy statement signed nearly a year ago by President Reagan and Prime Minister Nakasone. Part of that agreement stated that Japan would "encourage its industries to consider purchase of more competitively priced U.S. steam coal to meet future demand" and that the government would "explore the possibility of further increasing substitution of coal for oil in electrical

generation." But in reality the United States has effectively been reduced to a role only as a "swing supplier" because of existing long-term contracts for coal from Australia, South Africa, Russia, and China. For the first 6 months of 1984, U.S. steam coal exports decreased 25.4 percent from the first half of 1983.

These persistent trade problems coupled with a rapidly growing deficit in bilateral trade with Japan are causing an outcry in virtually every segment of our economy for protectionist measures against both Japan and the rest of the world. Whether accurate or not, the American people feel that increased competition from Japan is causing unemployment here at home and that Japanese exporters have greater access to our market than we do to theirs. Now I don't think we in Congress necessarily want to be restrictionist in our trade policies with any other nation, but when you see the Japanese only just continue to "talk to us" and go on to make long-term commitments with other nations for their coal—when they refuse to drop quotas on beef and oranges and instead provide for only a very short-term increase in existing quotas—then you see increased calls for punitive trade measures. Domestic content legislation has already passed the House of Representatives. Just last month the U.S. Customs Service published new regulations to tighten U.S. quotas on textile imports. Just this month the Senate passed a comprehensive trade bill that includes something for each of the major trade case losers of the past year—the copper producers, the shoemakers, and the wine producers. The House-passed trade bill greatly increases the opportunities for litigation by greatly expanding the definitions of dumping and subsidies.

I fear that more legislation—beyond even that which I've described—will come to pass which none of us really fully favor. Japan is one of our Nation's very best customers—and we are one of their best. So to see the Japanese Government enter into long-term coal contracts with other nations—leaving us as a residual supplier—is neither right nor appropriate in view of the presently distorted trade imbalance between the two nations.

Now is the most opportune time for the Japanese to initiate a long-term agreement for U.S. coal. The United States has the demonstrated ability and means to deliver a high-quality product in sufficient quantities at fair prices and the Japanese would also gain greatly from a decrease in the continuing trade tensions between the two nations.

[Shell Oil Co.'s prepared statement follows:]

Shell Mining Company
P.O. Box 2906
Houston, TX 77252

SUBSIDIARY COMPANIES
R&F COAL COMPANY
TRITON COAL COMPANY
TURRIS COAL COMPANY

Jack L. Mahaffey
President

September 26, 1984

The Honorable Frank H. Murkowski
United States Senate
317 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator:

I would like to express my appreciation for your invitation to appear before the Senate Foreign Relations Subcommittee on East Asia and Pacific Affairs at its October 3, 1984 hearing. We regret not being able to appear at the Subcommittee's hearing, but wish to take this opportunity to convey our thoughts to you and the Subcommittee in this letter.

Although Shell is not currently a coal exporter, we have been actively involved for several years in trying to develop export trade with Japan and other Pacific Rim countries through both direct sales and specific project joint venture opportunities. Additionally, Shell has been an active participant in the Western Coal Export Council and its Executive Committee. We also believe that increased coal exports represent one of the few meaningful opportunities to significantly reduce this country's mounting trade deficit, and thus, we appreciate your efforts and those of the Subcommittee.

Based on our experiences, there appear to be several very key issues such as long term contracts, equity participation and transportation considerations that must be included if meaningful progress is to be made in increasing U.S. coal exports.

First is the issue of long term contracts. Recently, Pacific Rim countries, such as Japan, which represent the most promising marketplace for increases in U.S. coal exports, have focused primarily on U.S. sales to satisfy "swing" demand while looking to other coal producing countries such as South Africa, Australia, and Canada to satisfy their base demand. Our suggestion would be to include a long term contract provision in any proposed coal solution to the trade deficit problem. There is overwhelming evidence that the U.S. coal and related industries are both willing to substantially increase coal exports if long term contract requirements are properly addressed. A long term agreement provides advantages to both buyer and seller. To the buyer, such arrangements offer the security of an assured supply at a predictable price. This insures protection from wide fluctuations in the marketplace which may result from strikes, political unrest, or changes in prices for

alternative fuels. The seller can also operate more efficiently, and thus offer a more competitive price, when it is able to develop and implement long range plans. The financial commitments required of the private sector to develop and maintain the costly coal chain capabilities (mines, transportation and port facilities) are necessarily contingent on a predictable, assured level of coal exports over a sufficient time frame (i.e., 20 years or more) to amortize these financial commitments. Long term contracts provide the means to secure these investments, as well as insure job protection and security of supply to the buyer.

Another means of assuring the development of long term coal supply arrangements is the encouragement of joint ventures and other means of shared equity interest by potential trading partners. The opportunity to attract foreign investment capital in U.S. coal export projects such as mine, transportation and port developments should be pursued to help to insure the long term commitments necessary to financially secure such projects.

I strongly urge that you and other members of our Congress together with the Administration make a concerted effort to convey this message to potential coal importing countries such as Japan. The longer we wait the greater the risk of increased competition from other potential coal exporters such as China and Columbia.

Next, and possibly as important as the development of long term contracts, is the transportation issue. Foreign coal trading partners such as Japan constantly point to the high (and uncertain) cost of inland transportation to move coal from mines to port. Since the implementation of the Staggers Act of 1980, this has become even more of an issue. For "captive" coal mines with no alternate mode of transporting coal, a legitimate concern does exist. The solution in our view is twofold. The issue of market dominance and captive shippers must be effectively readdressed by the Interstate Commerce Commission as must the issue of exempting coal export tariffs from any regulation. Also, the promotion of competition to rail transportation should be accomplished by giving coal slurry pipelines the right of federal eminent domain and other necessary provisions to move forward. Because transportation costs are such a significant portion of the delivered cost of coal to any potential importer, and have been the focus of attention when discussing why U.S. coal is not considered more favorably, renewed efforts are recommended in the above mentioned areas.

In closing, let me emphasize that coal and coal exports are capable of playing a very important role in a solution to the trade deficit problem. This potential was certainly recognized by President Reagan and Prime Minister Nakasone in the Joint Policy Statement on Energy Cooperation issued in November of 1983. The U.S. has the coal resources and the producers and transporters who are willing and able to make supply commitments. The Japanese clearly have the long term need for increased coal imports. The missing ingredient is the willingness on the part of the Japanese to recognize the interrelationship between the trade deficit

and the issue of coal trade and thus their unwillingness to undertake the necessary steps, i.e., long-term contracts or equity investments, to support competitive coal projects. The development of long term contracts is, we believe, a key ingredient to the objective of developing a long term solution to the trade deficit issue.

Your past support of the broad issue of expanding U.S. coal trade to Japan is most appropriate and appreciated, particularly your efforts relative to the Japanese Coal Mission to Washington in May. With continued support from you and the Senate Foreign Relations Subcommittee, workable solutions to these issues can be achieved in a manner that will be mutually beneficial to our country and to our existing and potential coal trading partners.

Sincerely,

Jack L. Mahaffey

Senator MURKOWSKI. I would like to at this time call upon the two witnesses, and I have no order of preference as to who begins the discussion. It is strictly up to you, Mr. McCoy, and you, Ms. Holmes.

I guess Ms. Holmes has waived the honor, so Mr. McCoy please proceed.

STATEMENT OF MICHAEL R. McCOY, VICE PRESIDENT, INTERNATIONAL COAL MARKETING, GETTY MINERALS MARKETING, INC., GOLDEN, CO

Mr. McCOY. Mr. Chairman, my name is Mike McCoy, vice president of Getty Minerals Marketing.

The statement I am about to present was prepared by Mr. C.R. Moore, president of the Getty Minerals Marketing and the current president of the Western Coal Export Council. Recently Mr. Moore was privileged to serve as the cochairman of the U.S. delegation to Tokyo in September for the first Standing Technical Committee [STC] meeting with Japan.

I would like to report on the progress of these recent meetings. I will specifically address the prospects for steam coal.

A formal written statement has been provided, and my verbal presentation will be somewhat abbreviated.

Senator MURKOWSKI. Your entire statement will be entered into the record.

Please proceed.

Mr. McCOY. As you know, we are here today as a result of the Joint Policy Statement on Energy Cooperation signed by President Reagan and Prime Minister Nakasone on November 11, 1983. That statement says that "the sound expansion of United States-Japan energy trade will contribute to the further development of the close economic and energy security relationship which exists between the two countries." The statement further outlines steps to be

taken by the private sector of the United States and Japan to promote coal trade between the two countries.

The Joint Policy Statement on Energy Cooperation of November 11, 1983, was a government-to-government agreement agreed to by the heads of state of the United States and Japan. It was rather unique in that it provided that the two countries would take positive steps to encourage their private industry to explore the various means of increasing coal trade from the United States to Japan. This must be contrasted with the negotiated trade agreements on other trade-related issues such as beef, citrus, telecommunications, which were worked out almost entirely on a government-to-government arrangement.

In the case of coal trade, private industry on both sides was asked to implement a trade agreement that has been negotiated by their respective governments.

In reporting the progress of the Standing Technical Committee, I believe it fair to state that both sides have complied with their government's request, but unfortunately in the steam coal area we have identified no short-term prospects. In other words, there has been little progress.

Regarding the mid- to long-term prospects, there are continuing efforts on a company-to-company basis to develop projects that would make U.S. coal more competitive. We commend both the Electric Power Development Co. and Diamond Shamrock Corp. on their joint announcement of a prefeasibility study of Alaskan coal. It must be recognized that some of the major reasons for U.S. coal being uncompetitive with supply sources from other countries are the economic advantages afforded by utilizing cheaper labor, subsidized mining operations and transportation, as well as direct investment by Japan.

I believe that on the basis of international trade and security relations there are many reasons why Japan should buy steam coal from the United States. Our customers in Taiwan, for example, have taken due recognition of these facts, where this year they are importing approximately 50 percent of their steam coal requirements from the United States.

While we in the private industry sector will continue to work for expanded coal trade, definite progress in the U.S. coal trade may only be possible through the efforts of the U.S. Government to persuade the Japanese Government that expanded coal trade is in the interest of overall United States-Japan relations.

We in the private industry would like to sincerely thank Members of the Congress who have been extremely supportive in our efforts to seek ways of increasing coal trade between the United States and Japan. Meetings held in Washington in May of this year and in Tokyo in September were held on the initial steps for implementing the joint policy statement of November 11, 1983. I believe that the discussions on both sides were very frank and very open and allowed us to expand and develop new friendships with our counterparts in Japan.

I regret that I am unable to report any significant progress in achieving the five steam coal objectives of the joint policy statement. Discussions during the STC meeting indicated nothing to evidence any change in the Japanese attitude toward the United

States as a swing supplier, nor to recognize the interrelationship between coal and the political and trade relationships between our two countries.

I think we must all take due note of the recent report of the United States-Japan Advisory Commission that submitted its report to Prime Minister Nakasone and President Reagan. The report noted that an unacceptable level of friction is eroding good will and mutual trust between the two countries because issues tend to become politicized before sufficient efforts have been made to resolve them at an administrative level.

I believe that the private industry in the United States, including coal producers, railroads, and port loading facilities have devoted considerable effort over the past few years to define the issues in the United States-Japan coal trade and seek ways of increasing our coal exports.

There remains a real question as to the private industry's role in resolving the overall trade balance.

That concludes my statement.

[Mr. Moore's prepared statement follows:]

STATEMENT OF

C. R. MOORE

PRESIDENT, GETTY MINERALS MARKETING, INC.

AND

PRESIDENT, WESTERN COAL EXPORT COUNCIL

BEFORE THE

UNITED STATES SENATE

SUBCOMMITTEE ON EAST ASIA AND PACIFIC AFFAIRS

OF THE COMMITTEE ON FOREIGN RELATIONS

WASHINGTON, D.C.

OCTOBER 3, 1984

A. INTRODUCTION

Chairman Murkowski, Senators, and distinguished guests, my name is Pete Moore. I am the President of Getty Minerals Marketing and currently serve as President of the Western Coal Export Council (WCEC). Recently I was privileged to serve as co-chairman of the U.S. delegation to Tokyo, September 11-12 for the first Standing Technical Committee meeting with Japan. I would like to report on the progress of these recent meetings. I will specifically address the prospects for steam coal.

As you know, we are here today as a result of a Joint Policy Statement on Energy Cooperation, signed by President Reagan and Japanese Prime Minister Nakasone on November 11, 1983. That statement says that "the sound expansion of U.S.-Japan energy trade will contribute to the further development of the close economic and energy security relationship which exists between the two countries." The statement further outlines steps to be taken by the private sector of the United States and Japan to promote coal trade between the two countries.

It has been ten months since the signing of the Joint Policy Statement. I would like to review for you the progress made with respect to U.S. steam coal exports in implementing the goals of the Joint Policy Statement.

First, let me provide you with some background information on U.S.-Japan trade in steam coal.

B. BACKGROUND ON U.S.-JAPAN STEAM COAL TRADE

In 1979 and 1980, representatives of Japanese utilities, cement companies, trading companies, banks, and other private sector leaders came to this country. They also invited leaders of U.S. coal-chain industries to visit Japan.

The message in these visits was "the Japanese commitment to greatly expand the use of steam coal." The Japanese leaders--both public and private--also emphasized Japan's commitment to diversify sources of supply so that Japan's economy would not become vulnerable to one or two supply sources. One after another, industry and government leaders in Japan said, "We learned our lesson with oil. In the steam coal trade, we shall establish a diversified structure of supply. Moreover, sourcing decisions shall be based on a variety of criteria--and not just price." Other criteria included coal quality, supply adequacy, and reliability.

American coal-chain industries--coal producers, railroads, and ports--accepted these statements of business policy and public policy at face value. In fact, private-to-private discussions were backed up by voluminous reports of rapidly expanding coal demand in Japan. These reports were generated by governmental and quasi-governmental agencies--including MITI, JCDC, NEDO, EPA, Institute of Energy Economics (IEE), and others.

In response to these indications of rising demand and of new sourcing policies issued by public and private leaders, U.S. coal-chain industries were preparing to gear up for new markets in Japan.

But nothing happened. The U.S.-steam coal export boom, to be stimulated by Japan, fizzled. The expected steam coal boom happened in Australia. It happened in Canada. It happened in South Africa . . . and even in the People's Republic of China. But it did not happen in the U.S.A.

That has been difficult for the U.S. side to understand--particularly when we compare the sourcing standards, criteria, and policies we were told to expect . . .with the sourcing practices we have observed since 1981.

There have been many negative consequences for the U.S. side as a result of Japanese sourcing practices:

First, many ambitious U.S. port development projects encouraged by Japanese demand estimates and sourcing policies have been cancelled, slowed down, reduced in scope, or put in mothballs--most recently the coal terminal at Portland, which is 80% complete, employing some of the most modern coal-handling equipment. At one time, for example, as many as 26 west coast coal ports expressed an interest in developing a coal export capability. Today, that number is less than a dozen--including Long Beach, Los Angeles, Stockton, Levin-Richmond, Sacramento, Portland, Seward, and perhaps a few others.

Second, joint ventures with Pacific Rim partners have been curtailed or scrapped altogether. Recently, for example, the joint venture in western Colorado between Dorchester Coal Company, JCDC and the Sumitomo Corporation failed to materialize within the previously anticipated time frames.

Third, domestic coal mine expansion and development projects, which were based on the anticipated growth of export markets, have been cut back, causing layoffs of miners and management personnel.

C. RECENT ACTIVITIES

In line with the Joint Policy Statement, Japanese coal users undertook a mission to the U.S. in May, 1984 to meet with U.S. coal-chain industries and government officials. During these meetings the foundation was laid for implementation of the Joint Policy Statement through a Standing Technical Committee (STC). The support we received in meetings with Senators and Congressmen (including Senators Murkowski and Simpson and Congressman Rahall and the Congressional Coal Caucus) was intended to establish the linkage between coal trade and the broader bilateral relationship in general and the trade deficit specifically, and to impress upon the Japanese delegation the

importance of the U.S.-Japan trade imbalance to the American people and the enthusiastic support that exists for expanded coal trade.

As you know, the STC held its first meeting in Tokyo September 11-12 to review progress made and actions taken to implement the Joint Policy Statement.

The Japanese side noted that in 1983 they revised their long-term energy forecast to base future electrical demand on an annual growth rate of 1.5%. This lower energy forecast reduced their projected steam coal demand for 1990 by approximately 15 million tons to 26 million tons. Of this total of 26 million, 16 million will be supplied from imported sources of which 15 million are already committed.

While the actual electrical growth in 1984 has been up 7.5% over 1983 as compared to 1.5%, the utilities believe it is premature to revise their long-term forecast.

This meeting demonstrated that little substantive progress has been made on the Japanese side, either in attitude or in specific activities directed toward achieving the five steam coal objectives in the Joint Policy Statement.

With regard to the use of long-term contracts, objective #1, Japanese coal users say that demand is too uncertain for the use of such contracts. At the same time, these coal users say that commitments to Canadian, Australian, and other suppliers prevent them from taking U.S. steam coal before the early 1990's.

We have seen no progress on the second objective, which calls for the joint development of mines. There are no indications of forward movement on the Fruita project in western Colorado or any other joint efforts.

Objective 3 calls for joint development of transportation systems. We are not aware of any progress on individual U.S. projects, though several opportunities for joint development exist.

The only proposal advanced by the Japanese utilities on steam coal was to undertake a study to reduce the price of U.S. steam coal. This general study would last approximately one year and would focus heavily on opportunities to reduce transportation costs. To date we have not been furnished an English translation of the study proposal. For the last 3½ years, there has been a myriad of studies on coal trade from the U.S. to Pacific Rim countries. Some of these have been U.S. sponsored, some Japanese sponsored and some joint studies, and most have focused on the transportation elements of the coal chain. Most of my colleagues on the U.S. side believe the problem has been overstudied and do not see how another repetitive general study will contribute anything to increased coal trade.

Regarding objective 4, expanded use of U.S. steam coal by utilities and other industries, reports from Japan prior to the STC meeting indicated that utilities would purchase one million tons of U.S. steam coal in 1985. This would represent an increase in trade from 1983 and 1984, but a decline from the 4.3 MMT purchased in 1981 and 3.4 MMT in 1982. Nevertheless, we were unable to confirm the reported one million ton level.

Objective 5, conversion of oil-fired plants to coal, has encountered many obstacles. To date, only five million KWH of Japan's 58 KWH capacity has been converted to coal. Japanese utilities have studied further conversions and say that all possible conversions have been made, with additional changes to coal being blocked by environmental or other considerations.

D. CONCLUSION

Senator Murkowski, the industries producing and moving steam coal stand firmly behind the principles of the Joint Policy Statement. We have invested millions of dollars in our mines and export capacity based on expectations of increased Japanese coal demand. We have held down our mine and transportation costs in an effort to provide a stable, low-cost supply to Japan.

Nevertheless, we find that the exports we provided in 1979-82 simply bridged a gap in supply for Japanese coal users, allowing other suppliers to build their infrastructure (often with Japanese assistance) and resulting in oversupply in the world coal market, which has held prices artificially low. Discussions during the STC meeting indicated nothing to evidence any change in the Japanese attitude toward the U.S. as a swing supplier, nor to recognize the interrelationship between coal and the political and trade relationships between our two countries.

As you know, Japan is one of the U.S.'s largest trade partners. This year's trade deficit will probably surpass $30 billion. We have seen the proposals for import restrictions to curb this trade deficit. We recognize the seriousness of the trade imbalance and continue to believe that expanded coal trade offers a positive solution.

We appreciate your attention and support and will continue to work with you to build a stable coal trade with Japan which will prove mutually beneficial to both countries.

Senator MURKOWSKI. Thank you very much, Mr. McCoy.
Ms. Holmes.

STATEMENT OF CONNIE HOLMES, EXECUTIVE DIRECTOR, COAL EXPORTERS ASSOCIATION, WASHINGTON, DC

Ms. HOLMES. Thank you.

My name is Connie Holmes. I am executive director of the Coal Exporters Association. I am appearing here today on behalf of our chairman and the cochairman of the U.S. delegation to the United States-Japan Standing Technical Committee on Coal, Mark Joseph. He sends his apologies that he was detained in London and could not return in time to appear here today.

Senator MURKOWSKI. We appreciate the fact that you are here.

Ms. HOLMES. We were asked to address the question, can coal help solve the $30 billion plus trade deficit the United States currently has with Japan? The coal industry believes that the answer to that question is a definite yes. Coal can be part of the solution, but it is going to take a great deal of effort and help on the part of both Congress and the administration.

As Mr. McCoy mentioned in his statement, the administration in the energy area made many efforts through the United States-Japan Energy Working Group which culminated in the Joint Policy Statement on Energy Cooperation which was issued in November 1983 by Prime Minister Nakasone and President Reagan. As a direct result of this agreement, Japanese coal users sent a high level private industry delegation to Washington last May to meet with U.S. coal exporters to discuss the specific actions identified in the policy statement which, if accomplished by both sides, could both expand Japanese imports of U.S. coal and increase coal use in Japan.

At the conclusion of these meetings—and I might add, as a direct result of the special meeting that we held with you and other leaders of the Senate, as well as with administration officials, we began to believe that Japanese coal users had at least started to indicate a recognition of the need to take responsible action to implement the coal objectives included in the Reagan-Nakasone agreement.

But it was also evident that many issues affecting both Japanese coal use and the import of United States coal required further clarification and discussion. The United States and the Japan private industry jointly agreed to establish the Standing Technical Committee on Coal to consider these issues in more detail, and 2 weeks ago our committee met in Tokyo for the first time to discuss both these issues and the current status of United States-Japan coal trade. The U.S. delegation went to Tokyo with high hopes, and we had hoped to achieve both short and long term goals and to lay the ground work to develop the concrete plan for further action by both sides, to increase both steam and metallurgical coal trade.

Despite some good and frank discussions, we were frankly disappointed by the outcome of this meeting. Mr. McCoy has discussed the results of the STC meeting from the steam coal point of view, and I would like to touch on the viewpoint of the metallurgical coal producers and exporters.

Our written statement discusses the historical and the current status of our met coal trade with Japan, but at this point it is sufficient to say, that as you mentioned in your opening remarks, over the last 20 years our U.S. coal and transportation industries have developed an extensive exporting infrastructure, and that infrastructure was developed in large part on the basis of an indicated current and future Japanese market.

But unfortunately, that market materializes on a very sporadic basis. When met coal cannot be obtained elsewhere, we, the U.S. exporter and producer, are asked and we are expected to fill the gap. But when normal suppliers return, the U.S. coal is essentially forgotten, despite the fact that the United States is Japan's largest customer for steel and steel-related products.

Essentially, Senator, the United States is buying steel made with Australian, Canadian, U.S.S.R., and Chinese coals. We had hoped, and we still do have hope, that with continued assistance from our Congress and the Government, the Japanese will finally recognize that additional imports of U.S. coal will reduce the trade imbalance and will help preserve the Japanese best market for their manufactured goods.

The efforts of the Congress and the administration through the United States-Japan Energy Working Group have at least started this process. But the results of our meeting in Tokyo show us very clearly that we have progressed only a foot or so of the very long mile that we have to go before we can make substantial gains in increasing our coal trade.

Despite a start, from the viewpoint of the U.S. metallurgical coal producer and exporter, little concrete progress has been made by the Japanese in implementation of the objectives included in the Reagan-Nakasone agreement issued 10 months ago.

The first objective states that the United States and Japan will encourage private industry in both countries to discuss the possibility of long-term contracts. To date, in the metallurgical coal area there has been no progress in concluding long-term contracts for metallurgical coal. In Tokyo we were told that the Japanese steel industry has little interest in long-term contracts as we know them.

In fact, the outlook for any increase in the purchase of U.S. met coal in the near term is not promising. Despite a marginally improved outlook for steel, the steel industry in Japan, the Japanese are committed to take full contract tonnages from new mines being opened in Australia and Canada and are taking more coal from the U.S.S.R. and China. Therefore, we were told that quantities of coal from existing sources will have to be cut to make room for this tonnage. We were bluntly told that the United States will continue to bear the brunt of these cuts.

Over the longer term, this new contract tonnage may be reduced, and at that time, additional U.S. coal may be considered, but only if it is competitive, and competitive as evaluated on the basis of a Japanese evaluation.

Other objectives of the Reagan-Nakasone agreement state that the possibility of joint development of mines and transportation systems could assist U.S. coal in the Japanese market.

Again in the met coal area, to date there has been no progress in achieving these objectives. Frankly, we do not expect any in these areas because they are much more applicable to the steam coal projects than to developing an already overdeveloped metallurgical coal exporting industry.

The third objective related to met coal states that Japan expects that imports of competitively priced U.S. met coal will not continue to decline and will encourage its steel industry to increase U.S. coal imports when conditions in the industry permit. Through efforts on both sides, we are pleased to report that partial progress on this point has been achieved. U.S. coals are more competitive in the Japanese market. Our prices have come down, and U.S. shipments of met coal to Japanese steel mills have not declined in this fiscal year as previously expected, but they have remained stable.

But on the other hand, as I pointed out, they have not increased either as conditions in the steel industry in Japan have improved.

The U.S. delegation attended the STC meeting hoping to achieve several short- and long-run goals. In the short run we were hoping to obtain a concrete indication that the Japanese purchase of met coal would not decline in fiscal year 1985 but would instead increase by some amount consistent with an increase in steel production.

Over the longer term, we hoped to lay the groundwork to jointly develop a plan to increase shipments of United States met coal to Japan until the average stabilized at a more traditional one-third market share level.

Unfortunately, none of these goals have yet been accomplished. Instead, we found a rather difficult situation. We found that the steel companies are not yet willing to acknowledge that the trade deficit is a problem of Japanese private industry and must be addressed and solved by Japanese private industry. We were told it is a government problem. In other words, the Japanese steel companies still do not believe that their failure to buy U.S. coal could possibly in any way affect their U.S. market for steel and steel products.

Mr. Chairman, this morning we heard witnesses use the word "gradual," and we recognize that an improvement in our coal trading relationships will be gradual, and that we must be patient and we must be persistent. And so despite the lack of progress evidenced at this first STC meeting, we agreed to keep the door open, and we agreed to meet through the auspices of the STC at least twice a year to continue these discussions.

The coal industry, both the met and the steam coal exporting industry, remain committed to the principles of the joint policy statement, and we will continue on a private industry basis to press the Japanese for concrete progress toward implementation of that agreement. The U.S. industry on our part will continue to work to hold down costs and to remain competitive in the Japanese market, but without continued strong support and pressure by our Government, it is very unlikely in our opinion that anything beyond a cosmetic solution will be achieved. The support has to come, and it has to come from both Congress and the administration.

As an immediate step on the part of the administration, we would hope that the experts group of the United States-Japan

Energy Working Group could meet at a very early time to assess the results of the STC meeting that we just held from a bilateral government point of view and to recommend further action that the government can take, again on a bilateral basis, to encourage the increase in coal trade.

Mr. Chairman, we appreciate your continued interest and support of our efforts in this area, and we look forward to working with you to make increased coal trade a reality.

Thank you.

[Mr. Joseph's prepared statement follows:]

NATIONAL COAL ASSOCIATION

STATEMENT OF

MARK R. JOSEPH

PRESIDENT, MARAN COAL SALES

CHAIRMAN, COAL EXPORTERS ASSOCIATION

ON

THE U.S.-JAPAN STANDING TECHNICAL COMMITTEE ON COAL

TO THE

EAST ASIAN & PACIFIC AFFAIRS SUBCOMMITTEE,

SENATE FOREIGN RELATIONS COMMITTEE

OCTOBER 3, 1984

I. INTRODUCTION

Senator Murkowski, my name is Mark R. Joseph. I am the President of Maran Coal Sales, a coal exporting firm based in New York and am the Chairman of the Coal Exporters Associaiton (CEA). I am pleased to be here today, as Co-Chairman of the U.S. delegation to the U.S. Japan Standing Technical Committee on Coal (STC) to report on the results of the first meeting held September 11-12, 1984 in Tokyo.

II. BACKGROUND

Approximately eighteen months ago, Prime Minister Nakasone and President Reagan concluded that an increase in energy trade could enhance already strong economic ties between the United States and Japan, improve energy security in Japan and assist in correcting the growing trade deficit which this year will be in excess of $30 billion. The Japan -U.S. Energy Working Group, a government to government group, was formed to find ways to accomplish these goals.

The initial efforts of the Group culminated in the "Joint Policy Statement on Energy Cooperation" issued in November, 1983 by Prime Minister Nakasone and President Reagan.

As a direct result of the this Agreement, Japanese coal users sent a high level private industry delegation to Washington last May to meet with U.S. coal exporters. to discuss the specific actions identified in the Policy Statement which, if accomplished could expand Japanese imports of United States coals and increase

coal use in Japan.

At the conclusion of the May meetings, and, as a direct result of special meetings with yourself and other leaders of the Senate and several Administration officials, Japanese coal users began to recognize the need to take responsible action to implement coal objectives included in the Reagan-Nakasone Agreement. But it was also evident that many issues affecting Japanese coal use and the import of U.S. coal required further clarification and discussion.

We jointly agreed to establish the Standing Technical Committee on Coal (STC) to consider these issues in more detail.

The meeting two weeks ago in Tokyo was the first meeting of the committee and was held for the purpose discussing the current status of U.S. Japan coal trade, and the progress made in the 10 months since November, 1983 in implementing the objectives of the Reagan-Nakasone agreement. The U.S. delegation had also hoped to lay the groundwork to develop a concrete plan for further action by both sides.

III. THE CURRENT STATUS OF MET COAL TRADE WITH JAPAN

Our metallurgical coal trading relationships with Japan have a history of almost 30 years. High quality lo and mid vol coking coals formed the basis for the development and growth of the Japanese steel industry. At the same time, Japanese purchases of coal encouraged the growth of our American coal and rail industries especially in the Appalachian states.

From the early 1960's, U.S. Japan trading relationships

began to change from the long to the short term as coal from Australia and other sources began to enter the Japanese market for supply diversity and cost reasons. To respond to Japanese concerns about costs the U.S. coal exporting chain made significant improvements in the mining and transportation infrastrucure serving the Japanese market. However, despite these efforts the United States share of the Japanese market rapidly dropped from 60 percent or greater to the 40 - 45 percent range.

Since 1970, Japanese imports of United States metallurgical coals have fluctuated widely both in terms of tonnage and market share. The United States has become a "swing supplier" to Japan, and changes in demand for U.S. coal have occured in response to availablility of supply in competing countries and not, as would be expected, to steel production levels.

In 1980, Japanese requirements for coal for use by the steel industry increased again and United States suppliers were approached to meet short term shortages in supply.

Despite severe logistical problems, the United States coal exporting chain delivered and increased shipments to Japan by more than 6 million tons, or by over 42 percent in 1980 followed by further increases 1981 and in 1982 returning the U.S. share of the Japanese market to the traditional one-third.

But in 1983, U.S. met coal exports to Japan dropped by almost 40 percent, or by 10 million tons. Market share dropped to less than 25 percent. Needless to say, this sudden decline in demand for met coal caused severe unemployment and economic

problems both in the coal fields and in related industries.

At the same time the U.S. supplier was cut back, MITI data show that imports of coking coal from Australia, Canada, the U.S.S.R., and China increased. We do not understand why Japan's best steel and steel related customer suffered this disproportionate loss in coal trade.

Japanese purchases of met coal did not decline again in 1984, but neither have they increased with an increase in steel production and we remain concerned about future opportunities for U.S. met coal in Japan.

IV. IMPLEMENTATION OF THE REAGAN-NAKASONE AGREEMENT

One of the purposes of the September STC meeting was a review of progress made by both side in implementing the coal objectives outlined in the November, 1983 Reagan-Nakasone Joint Policy Statement on Energy Cooperation.

A. PROGRESS ON THE UNITED STATES SIDE

In May, the Japanese pointed out that to meet the Policy Agreement objectives of an increase in coal trade, United States coals must, as stated in the Agreement, be "more competitively priced", and must offer a flexible and secure source of supply.

It goes without saying that the last two criteria have been proven many times over.

And in the last year, U.S. coal exports have indeed become more competitvely priced as the differentials between the c.i.f. prices of U.S. coals and those of our competitors have narrowed significantly. This has been due to a decline in the average

mine mounth price of U.S. met coal and stable of lower inland and port transportation costs.

B. PROGRESS ON THE JAPANESE SIDE AND THE OUTLOOK FOR THE FUTURE

From the U.S. viewpoint, little concrete progress has been made by the Japanese in implementation of the objectives included in the Reagan-Nakasone Agreement.

The first objective states that "the U.S. and Japan will encourage private industry in both countries to discuss the possibility of concluding long-term contracts coals to make U.S. coal more competitive in the Japanese market."

To date, there has been little progress in concluding long term contracts for met coal. In Tokyo, we were told that the Japanese steel industry has little interest in long term contracts as we know them.

In fact, the outlook for any increase in the purchase of U.S. met coal in the near term is not promising, although Japanese steel representatives did say the imports of U.S. met coal are not expected to show further decline.

The Japanese are committed to take full contract tonnages from new mines now being opened in Australia and Canada and in the short term, quantities of coal from existing sources will have to be cut to make room for this tonnage. Due to its higher cost structure we were told that the U.S. will continue to feel the brunt of the cuts.

Over the longer term, this new contract tonnage will also

be reduced and at that time additional U.S. coal may be considered but only if it is "competitive", on a basis as evaluated by the Japanese.

Objectives Two and Three state that possibility of the joint development of mines and transportation systems to make American coal more competitive in the Japanese market should be explored. To date, there has been no progress in achieving these objectives but they are more applicable to steam coal projects than to the already developed met coal exporting industry.

The third objective related to met coal states that "Japan expects that imports of competitively prices United States metallurgical coal will not continue to decline and will encourage its steel industry to increase U.S. coal imports when conditions in the industry permit." Through efforts on both sides partial progress on this point has been achieved. U.S. coals are more competitive in the Japanese market and U.S. shipments of met coal to Japanese steel mills have not declined in this fiscal year as previously expected but have remained stable. But, as I pointed out, they have not increased as the conditions in the steel industry in Japan have improved.

V. THE OUTCOME OF THE STC MEETING

The U.S. delegation attended the STC meeting hoping to achieve several short and long range goals. Specifically, in the short run we were looking for a concrete indication that Japanese purchases of met coal would not decline in FY 1985, but would instead increase by some amount consistant with an

...crease in steel production.

We expected to lay the groundwork to jointly develop a long term plan to increase shipments of United States met coals to Japan until the average stabilizes at more traditional market levels.

None of these goals were accomplished.

The U.S. delegation was very disappointed by the apparent lack of Japanese recognition of the political and economic importance of reducing the trade deficit and the role that coal can play to that regard.

Despite the lack of progress evidenced at the first STC meeting, the Committee agreed to meet at least twice a year to continue discussions. The U.S. side is especially disappointed in the lack of progress but remains committed to the principles of the Joint Policy Statement and will continue to press the Japanese for concrete indications of implementation of the Agreement.

The U.S. industry appreciates the support of the Congress and the Administration in this regard and looks forward to their continued support as we work to develop a more stable trading relationship with Japan.

BACKGROUND REPORT
OF THE
U.S. DELETATION
TO THE
U.S.-JAPAN STANDING TECHNICAL COMMITTEE ON COAL
TO THE
EAST ASIAN & PACIFIC AFFAIRS SUBCOMMITTEE,
SENATE FOREIGN RELATIONS COMMITTEE

OCTOBER 3, 1984

PRESENTED BY U.S. CO-CHAIRMEN
MARK R. JOSEPH AND C.R. MOORE

I. INTRODUCTION AND SUMMARY

The first meeting of the U.S. Japan Standing Technical Committee on Coal (STC) was held in Tokyo, September 11-12, 1984. The STC was formed in May, 1984 by representatives of the U.S. coal exporting chain and Japanese coal users for the purpose of implementing the November, 1983 Reagan-Nakasone Joint Policy Statement on Energy Cooperation and exploring the possibility of expanding coal trade between the United States and Japan.

The 25 delegates from the United States represented the membership of the Coal Exporters Association (CEA), the Western Coal Export Council (WCEC), the National Coal Association (NCA), the Mississippi Valley Coal Export Council (MVCEC), and the Mining and Reclamation Council (MARC). Representatives of the railroad, port and inland waterway industries were part of the delegation. The Japanese delegates represented Japanese steel, utility, and cement industries. Observers from the governments of the United States and Japan were present throughout the meeting.

The U.S. delegation requested that the Japanese coal users acknowledge the gravity of the political and economic problems

caused by the U.S. Japan trade imbalance and recognize that an increase in met and steam coal purchases from the United States would assist in solving this problem. An increase in coal trade would also assist in steming the rising sentiment within the U.S. Congress towards trade protectionism, preserving the Japanese best market for steel products and manufactured goods. Simultaneously, an increase in coal trade with the United States would enhance energy security in Japan.

The Japanese delegation did not give any concrete indication of intentions to purchase additional coal from the United States in either the short or the longer term. The political and economic importance of implementing the Reagan-Nakasone Agreement was not recognized.

Metallurgical coal exporters were told that, while coal purchases from the U.S. had "bottomed out", an increase could not be expected in the near term due to lower than forecast steel production and the need to take full commitments from newly delveloped mines in Australia and Canada.

United States steam coal producers/exporters were told that increased imports of U.S. steam coal were not possible at this time. All actual conversions of oil fired power plants to coal have been made, new coal fired plants are not coming on line as expected. Due to present supply overcommitments, U.S. steam coal will not have a place in Japan until sometime in the 1990`s.

II. BACKGROUND

Approximately eighteen months ago, Prime Minister Nakasone and President Reagan concluded that an increase in energy trade could enhance already strong economic ties between the United States and Japan, improve energy security in Japan and assist in correcting the growing trade imbalance which this year will be in excess of $30 billion. The Japan -U.S. Energy Working Group, a government to government group, was formed to find ways to accomplish these goals.

The initial efforts of the Energy Working Group culminated in the Japan-U.S. "Joint Policy Statement on Energy Cooperation" issued in November, 1983 by Prime Minister Nakasone and President Reagan. This Heads of State communique was a concrete indication of the high priority that the governments of the United States and Japan place on substantially increasing energy trade and most specifically coal trade. The communique identified six specific actions that could be taken to expand Japanese imports of United States coals and to increase coal use in Japan. These actions included:

1. The possibility of concluding long-term contracts for met and steam coal to make American coal more competitive in the Japanese market;

2. The possibility of the joint development of mines to make American coal more competitive in the Japanese market;

3. The possibility of the joint development of transportation systems to make American coal more competitive in the Japanese market;

4. Japanese encouragement of utility and other industries to expand imports of more competitively priced U.S. steam coal;

5. Exploration of the possibility of increasing the substitution of coal for oil in electrical generation in Japan;

6. The endeavor by both sides to maintain the level of Japanese imports of U.S. met coal and the exploration of the possibility of improving the competitiveness of and expanding trade in met coal in future years.

In May, 1984, as a direct result of the Reagan/Nakasone Agreement, the Japanese sent a high level delegation to Washington to meet with U.S. private industry to discuss coal trade. These meetings included discussions with the leadership of the Senate, several highly placed Administration officials and a special meeting with the House Coal Group chaired by Congressman Nick Rahall.

At the conclusion of the May meetings, private industry on both sides recognized the need to take responsible action to implement the Reagan-Nakasone Energy Trade Agreement. But it was also evident that many issues affecting Japanese coal use and the import of U.S. coal required further clarification and discussion.

We jointly agreed to establish the Standing Technical Committee on Coal (STC) to consider these issues in more detail and to find ways to implement the above listed points of the Joint Policy Statement on Energy Cooperation.

The meeting in Tokyo was the first meeting of the STC. The meeting was for the purpose discussing the current status

of U.S. Japan coal trade, the progress made since November, 1983 in implementing the Reagan-Nakasone agreement and to develop a concrete plan for further action by both sides.

III. THE CURRENT STATUS OF COAL TRADE WITH JAPAN

A. METALLURGICAL COAL

For 30 years, or until 1979, U.S.- Japan coal trade was almost entirely metallurgical coal. High quality lo and mid vol coking coals formed the basis for the development and growth of the Japanese steel industry following World War II and, at the same time, these purchases of coal helped the growth of our American coal and rail industries.

From the early 1960's, U.S. Japan trading relationships began to change. Coal from Australia and from other sources began to enter the Japanese market, partially as a result of the large cost of ocean freight rates from the United States East Coast to Japan. To respond to this concern, new coal loading piers were constructed on the East coast by the railroads and the U.S. began shipment of met coal from the Gulf and West Coasts. However, despite infrastructure improvements and other cost cutting measures, the United States share of the Japanese market rapidly dropped from 60 percent or greater to the 40 - 45 percent range.

Since 1970, Japanese imports of United States metallurgical coals have fluctuated widely both in terms of tonnage and market share. United States shipments of coking coal to Japan declined from 27 million tons in 1970, to 18 million tons in 1973, went

back to 28 million tons in 1974 and then plunged to 15 million tons in 1979 with market share declining to 24 percent. Peaks in tonnage were directly related to supply problems in Australia and not as would be expected to steel production levels. Australia has become the "base load" supplier of coal to Japan with the United States being called upon to play the role of the swing supplier, the supplier that fills in the gaps.

In 1980, Japanese requirements for coal for use by the steel industry were increasing, due both to an anticipated increase in steel production and to the substitution of coal for fuel oil in blast furnace operations. United States suppliers were approached to meet short term shortages in supply because an anticipated increase in coal supply from both Australia and Canada was not forth coming due to labor aand other problems.

Despite severe logistical problems, the United States coal producer and exporter, and the transportation system responded and increased shipments to Japan by more than 6 million tons, or by over 42 percent. We followed this with a further increase in shipments to 23.8 million tons in 1981 and to 26.4 million tons in 1982 returning the U.S. to the traditional market share of approximately one-third.

But in 1983, U.S. met coal exports to Japan dropped by almost 40 percent, or by 10 million tons. Market share dropped to less than 25 percent. At the same time, MITI data show that imports of coking coal from Australia increased by 11 percent, or by 3 million tons, and imports from the U.S.S.R., China,

and Canada increased a collective total of 1.2 million tons.

Japanese purchases of met coal did not decline again in 1984, but neither have they increased with an increase in steel production.

B. STEAM COAL

The United States relationship in steam coal trade, while much shorter in time, has been equally as volitile in nature.

In 1979 and 1980, Japanese short term demand for steam coal increased sharply due to a steep increase in the price of oil and to uncertain oil availablility. At the same time, steam coal was unavailable from Japan's more traditional source, Australia, because of labor strikes.

Japanese buyers came to the United States and found the steam coal that was required. In 1980, U.S. exporters shipped 1.7 million tons of steam coal to Japan, in 1981, 3.9 million tons and in 1982, 3.4 million tons. But in 1983, steam coal shippments to Japan suffered the same fate as metallurgical coal dropping to 1.7 million tons and in 1984 the total will be less that 500,000 tons. This occured despite a small increase in Japanese imports of steam coal.

Over the longer term, Japanese forecasts showed that steam coal use would increase dramatically throughout this decade as Japanese utilitiies and industry converted from more expensive, less reliable oil, to coal. Initial estimates of 1990 steam coal imports wer pegged at approximately 55 million tons versus 8 million in 1980.

In reponse to this demand the Japanese led the U.S. exporter to believe that Japan offered a long term market for substantial quantities of steam coal, especially for western steam coal. On the basis of these forecasts, plans were made to substantially upgrade the coal exporting infrastructure in the western states and on the west coast.

It now appears that, due to slower growth in electrical utility demand and a greater forecast use of nuclear power and LNG in utility plants, oil to coal conversions will not take place and new coal fired uitlities will not be constructed in the time frames originally planned. The Japanese now plan to import only 33 million tons of steam coal in 1990. Further, the Japanese have steam coal supplies under long term contract in competeing countries, primarily in Australia.

IV. IMPLEMENTATION OF THE REAGAN-NAKASONE AGREEMENT - PROGRESS TO DATE

One of the purposes of the September meeting was to review the progress to date in implementing the six objectives outlined in the November, 1983 Reagan-Nakasone Joint Policy Statement on Energy Cooperation.

A. PROGRESS ON THE UNITED STATES SIDE

In May, the Japanese pointed out that to meet the Policy Agreement objectives of an increase in coal trade, United States coals must be "more competitively priced" and gave several criteria that must be met if U.S. coals are to play a more significant role in the Japanese market in both the short and the long run.

For both met and steam coal, the Japanese stressed the importance of a stable supply source, and the capability to provide a flexible source of supply.

In presentations in September, the U.S. side pointed out that U.S. coals are proven in both categories. U.S. coal offers a stable source, one that will not be interrupted by political or domestic concerns. The U.S. coal exporter has proven the capability to be flexibile as demonstrated by our rapid responses to Japanese increases in demand.

In May the Japanese also stressed the need for U.S. coals to become more price competitive. Respresentatives of both the U.S. met and steam coal exporters pointed out that the price of U.S. coals has declined and that the differentials between the delivered price of U.S. coals and coals from competiting sources have narrowed significantly in the last year. The U.S. side pointed out that:

- the average mine mounth price of U.S. met and steam coal has dropped by several dollars per ton due to gains in productivity and other efficiences, thru a decrease - or outright elimination of the coal producer-exporters profitability;

- the costs of inland rail transportation have remained steady and in selected instances where contracts are involved have dropped;

- the costs of barge transportation are lower;

- new port terminals have come on line increasing competition between ports and lowering costs;

- larger vessels may be used to take coal from the east and gulf coasts by taking advantage of topping off operations now in place, large vessels may be fully loaded at certain ports on the west coast.

In short, the members of the United States coal exporting chain whether serving the steam coal or the met coal market, have recognized the need to be more competitive, have made every effort to keep down costs under our control and thus to keep the c.i.f. price of U.S. coal in Japan as low as possible and will continue to do so.

The U.S. delegation pointed out that further gains in cost competitiveness would depend upon the Japanese agreement to purchase U.S. coals on a long term, not a spot, basis.

B. PROGRESS ON THE JAPANESE SIDE

From the U.S. viewpoint, little concrete progress has been made by the Japanese in implementation of the six objectives included in the Reagan-Nakasone Agreement.

Objective One states that "the U.S. and Japan will encourage private industry in both countries to discuss the possibility of concluding long-term contracts for metallurgical and steam coals to make U.S. coal more competitive in the Japanese market."

To date, there has been little progress in concluding long term contracts for either type of coal.

Objectives Two and Three state that possibility of the joint development of mines and transportation systems to make American coal more competitive in the Japanese market should

be explored. To date, there has been no progress in achieving these objectives which are more applicable to steam coal projects than to the already developed met coal exporting industry. On the steam coal side there are ample opportunities to participate in mine development as well as in port improvements, modernization of coal handling equipment and in pipelines.

Objective Four states that there will be Japanese encouragement of utility and other industries to expand imports of more competitively priced U.S. steam coal. Recent reports have indicated that Japanese utilities plan to purchase one million tons of U.S. steam coal in FY 1985. This action would represent some small progress in implementation of the agreement, but the actual purchases have yet to be made and could not be confirmed during the September meeting.

Objective Five states that the Japanese will explore the possibility of increasing the substitution of coal for oil in electrical generation in Japan. We were disappointed to find that a study conducted by the Federation of Electric Power Companies concluded that there is little room for additional oil to coal conversions in Japan. The study further concluded that expansion of coal use in electric power plants will occur in new coal fired power plants in the mid-1990's.

The sixth objective states that "Japan expects that imports of competitively prices United States metallurgical coal will not continue to decline and will encourage its steel industry to increase U.S. coal imports when conditions in the industry

permit." Through efforts on both sides partial progress on this point has been achieved. U.S. coals are more competitive in the Japanese market and U.S. shipments of met coal to Japanese steel mills have not declined in this fiscal year as previously expected but have remained stable. But, they have not increased as the conditions in the steel industry in Japan have improved.

V. WHAT ARE THE GOALS OF THE UNITED STATES COAL EXPORTER?

The U.S. delegation attended the STC meeting hoping to achieve several short and long range goals. Specifically, implementation of the Reagan-Nakasone agreement would mean that in the short run:

-Japanese purchases of met coal would not decline in FY 1985, but would instead increase by some amount consistant with an increase in steel production;

- The Japanese utilities would confirm the intended purchases of one million tons of steam coal from the United States.

We expected to lay the groundwork to jointly develop a long term plan to increase shipments of United States steam and met coals to Japan until the average stabilizes at more traditional market levels in the case of met coal, and the average reaches traditional market levels in the case of steam coal. That plan would incorporate the six objectives outlined above.

VI. THE OUTCOME OF THE SEPTEMBER STC MEETING

The U.S. delegation was very disappointed by the apparent lack of Japanese recognition of the political and economic importance of reducing the trade deficit and the role that coal can play to that regard.

Metallurgical coal exporters were told that the outlook for any increase in the purchase of U.S. met coal in the near term is not promising, although imports of U.S> met coal are not expected to show further decline. Steel production in Japan is not expected to increase but will remain at 100 - 105 million tons per year. We were reminded that Japanese steel exports to the U.S. remain limited.

Further, the Japanese are committed to take full contract tonnages from new mines now being opened in Australia and Canada - despite the higher price of that coal (in Canada). In the short term, quantities of coal from existing sources will have to be cut to make room for this tonnage, and due to its higher cost structure the U.S. will continue to feel the brunt of the cuts.

Over the longer term, this new contract tonnage will also be reduced and at that time additional U.S. coal may be considered but only if it is "competitive"

The U.S. delegation was surprised to note that Japanese steel companies showed little interest in long term contractual arrangements with U.S. suppliers (Objective One) and were disturbed that differing criteria are used to evaluate contract potentials

and price levels in each supplying country oft times to the detriment of U.S. suppliers.

Steam coal exporters were told that the potential for conversion of additional oil fired power plants to coal was minimal. Additional use of steam coal will take place in 23 new power units representing 15,800 MW capacity. This new capacity will come on stream after 1990 and much of the coal required for these plants is under contract elsewhere.

The STC meeting demonstrated that little substantive progress has been made on the Japanese side in achieving the five steam coal objectives in the Joint Policy Statement. Long term contracts beyond those already in force with competing countries are not possible now because demand is too uncertain. There has been little progress in agreeing on joint development of mines or transportation projects.

Trade press reports indicated that Japanese utilities would take 1 million tons of steam coal in FY 1985, but this intention cannot be confirmed.

Despite the lack of progress evidenced at the first STC meeting, the Committee agreed to meet at least twice a year to continue discussions. The U.S. side is especially disappointed in the lack of progress but remains committed to the principles of teh Joint Policy Statement and will continue to press the Japanese for concrete indications of implementation of the Agreement.

The U.S. industry appreciates the support of the Congress and the Administration in this regard and looks forward to their continued support as we work to develop a more stable trading relationship with Japan.

Senator MURKOWSKI. Thank you, Ms. Holmes, and thank you, Mr. McCoy. You have pretty well corroborated, I think, that there has been little progress made to date, and the position of being a swing supplier is one that is certainly dictated by the purchaser.

And evidently you see little relief in sight for any long-term contracts.

Let me ask you this. Are there any long-term contracts, to your knowledge, being negotiated with Korea? You indicated that there have been with Taiwan.

Mr. MCCOY. There is a long term agreement out of Alaska with Taiwan Power Corp. and Kepco [Korea Electric Power Co.] That is a long-term contract.

Senator MURKOWSKI. Could you explain why in your opinion Taiwan and Korea would be willing to initiate long-term contracts and Japan is not? They can get the coal from the same sources, I assume, that Japan gets their coal.

Mr. MCCOY. I believe their decisions are heavily weighted by political circumstances, security of supply, relationships that have been established in the United States.

Senator MURKOWSKI. You are implying, then, that Korea and Taiwan have done it for political reasons and other reasons, and the Japanese are not doing it for the same reasons? Is that a fair statement?

Mr. MCCOY. The Japanese certainly are aware of the oversupply of coal in the world today and are taking advantage of market prices that are renegotiated year to year whereas and I will speak in terms of the contracts with Taiwan Power, that were negotiated on a long-term security of supply basis. Even though the price is negotiated annually or biannually, there is a definite commitment to come to an agreement around a market price for U.S. western coal.

Ms. HOLMES. Mr. Chairman, in the metallurgical coal area, you can say exactly the same thing. The Koreans and Taiwanese believe that they need to take more coal from the United States for political reasons. However, they do couple that recognition with concern about U.S. Government actions in the steel area which reduce our imports of steel, especially from Korea.

Senator MURKOWSKI. Especially from Korea.

Ms. HOLMES. Yes.

Senator MURKOWSKI. Who takes that, the Koreans?

Ms. HOLMES. No, sir. I am referring to some recent actions by the International Trade Commission and other actions that would reduce the U.S. imports of steel and steel products from Korea.

Senator MURKOWSKI. Do you have any comment on how you feel the current administration has handled the negotiations with the Japanese to date on coal? Or would you suggest that they may have mishandled it?

Mr. MCCOY. I think that there is a definite need for government-to-government meetings to keep the certain amount of political pressure that, as you have stated today, that there is a need to take care of their best customer. I do not have any specific suggestions or comments on the current action although I do recommend that the level of activity of the government to be involved should be kept up.

Senator MURKOWSKI. Do you feel that we have used whatever appropriate leverage we have in encouraging Japan to buy more coal from the United States as opposed to buying it from someone else, and if so, can you suggest leverage that we have not used that you feel would be appropriate?

Ms. HOLMES. The administration has done a great deal to keep the level of U.S. coal exports to Japan at current levels. Frankly, in the metallurgical coal area they have been successful, in the steam coal area, they have not.

As far as met coal is concerned, we feel that without the work of the United States-Japan Energy Working Group, the Congress and the administration at the very highest levels, we probably would have shipped 12 million tons of coal to Japan this year instead of the 15 million that we hope to ship. So the efforts have been successful in at least "holding the fort," and without Government assistance we would not have been able to do this.

I would concur with Mr. McCoy when he said the pressure has to continue. We cannot walk away and forget about the coal trade. The administration at the very highest levels, and I mean at the Presidential and Prime Ministerial level, have to continue to use the word coal, increased coal trade. The President must continue to pressure the Japanese Government to encourage both met and steam coal purchases from the United States.

As far as leverage is concerned, that is a very difficult question because, of course, what you ask for for one industry might subtract from another. But it seems to me that the administration and the Congress can certainly look at Japan and can look at the trade deficit and the fact that the United States is the best market for Japanese manufactured goods, and especially in the metallurgical coal area begin to at least look at tying steel and coal together.

In the steam coal area, I am less certain and Mike might be able to address that.

Senator MURKOWSKI. Do you have any leverage suggestions, Mr. McCoy?

Mr. MCCOY. I think we have to encourage the use of coal in substituting for the energy requirements of Japan that are being supplied by oil. Japan is a party to the International Energy Agency agreements to reduce the amount of oil being used. The U.S. Government has to encourage that activity. That is one area.

Senator MURKOWSKI. Do you believe the contention that generally speaking, U.S. coal is priced higher than exports from other nations, or are there some exceptions to that where our price per Btu is lower? Can you just make the flat statement that the reason that the United States is not competitive in coal or not a recipient of long-term contracts is because it is priced higher than other coal, everything else being equal?

Mr. MCCOY. I think Connie came prepared to answer that question with some specific statistics.

Senator MURKOWSKI. Make sure I can draw a conclusion from your statistics.

Ms. HOLMES. I will.

In the metallurgical coal area, it is true that U.S. coals are on average—and you can prove a lot of things with statistics—more expensive delivered in Japan than are other coals. That is not nec-

essarily true when you back that up to an FOB mine or an FOBT port basis.

An analysis that was recently published by a well known analyst in New York on new coal contract prices from Australia and Canada on a U.S. equivalent basis, show that new contract coal from Australia ranges from $59 to $60 per ton, FOBT the port. Coal from Canada, on a similar FOBT the U.S. port basis, ranges from $68 to $70 per ton. I might add that the equivalent U.S. price FOBT the U.S. port in August was $52 a ton. So we may be higher in some cases or on average, but you can show that in some cases the price of U.S. coal at the port is much lower. These costs are costs at the port of exit, for example, Hampton Roads, Mobile or a similar coal loading port in Australia or Canada.

We must look at ocean transportation costs, of course, and that does add some to the price of U.S. coal. But given the prices published by the New York analyst and adding the worst case transportation cost, the United States comes in even or slightly below.

Senator MURKOWSKI. Now, that is metallurgical?

Ms. HOLMES. That is metallurgical coal. Unfortunately, I do not have figures for steam coal.

Mr. MCCOY. I do not have any figures today, but I would be happy to send them to you when they are available.

Senator MURKOWSKI. I would like to have some figures on steam coal because the contention is generally made that Japan does not initiate long-term contracts because they can get it cheaper from someplace else. If that is not the case, I would like to know why.

In your opinion, is the dependence on the railroad to move our coal to market a deterrent? And, with regard to a coal slurry pipeline, access across public land from one State to the other has been something that has been debated in Congress extensively. It appears that the position of the railroads has dominated the activities of Congress in opening up slurry pipeline.

Do you feel this has been detrimental to the coal industry as a whole?

Mr. MCCOY. I have to speak in the area I am familiar with, in the Western United States, moving coal to the export facilities on the west coast. In the West there is more than adequate availability of capacity to move any foreseeable export quantity of coal in the future, and I commend the railroads for their involvement in export movements. They have been recognizing the competitiveness, the competitive position that the United States faces in supplying steam coal and competing with Australia and South Africa and other supplying countries and have been able to keep their rail rates quite reasonable.

On the issue of coal slurry pipelines, the lack of commitment of any throughput volume would keep any large capital investment where up to 10 million tons a year would be required to make a slurry pipeline economic.

Senator MURKOWSKI. Thank you very much, Mr. McCoy and Ms. Holmes.

I would ask that you bear with us for a moment for an interruption. I have basically concluded my questions, but we are very privileged to have join us an expert on coal, Senator Warner, who comes from the nearby State of Virginia, and has indicated his

willingness to make a statement on coal exports from the United States and the increasing trade imbalance from Japan.

We had one witness earlier, you might be interested to know, who indicated that the year end 1985 trade imbalance between the United States and Japan is projected to approach $45 billion. We anticipate at the end of this year it will be somewhere in excess of $30 billion.

Obviously we are looking for ways to offset this, and it has been brought out that while citrus fruits and beef are certainly important, they are not big ticket items and energy is. Meanwhle, Japan continues to buy more coal from Canada and less from the United States each year, and that is why we are here.

Senator Warner, we look forward to your statement.

STATEMENT OF HON. JOHN W. WARNER, A U.S. SENATOR FROM VIRGINIA

Senator WARNER. I am going to be very brief, Mr. Chairman. I would go to the latter part of my statement and ask that the statement in its entirety be made a part of this record.

Senator MURKOWSKI. Without objection.

Senator WARNER. I wish to commend the Chair and the members of this committee for holding this hearing and respectfully thank the witnesses for their indulgence in allowing me to go back to the floor momentarily.

I am strongly advocating that bilateral energy trading agreements for coal usage, especially with those countries like Japan, be implemented, Mr. Chairman. Japan enjoys, as you said, a trade surplus with the United States as well as the protection and mutual defense commitments for their country. And as former Secretary of the Navy and Under Secretary for over 5 years, I am very keenly aware of the contributions this Nation makes to the national defense of Japan.

Mr. Chairman, within the last 2 weeks the President requested the U.S. Trade Representative to negotiate similar type agreements with steel exporting countries, including Japan. The President directed the U.S. Trade Representative to include negotiations on a "voluntary restraint agreement" within 90 days with a number of steel producing nations to reduce the exports of steel to the United States. Japan has criticized President Reagan's decision, and the Japanese steel industry stated that they do not believe the trade deficit is their problem.

Furthermore, and more ominously, a Japanese Embassy official warned that any reduction in steel production in Japan would mean a reduced need for coking coal, presumably from the United States. Metallurgical coal is one of the main ingredients of high quality Japanese steel. Since Japan's steel industry has increased its steel output, it has cut back on purchase of American metallurgical coal.

The Japan steel industry does not believe that the U.S. trade deficit is a problem. I take extreme objection to that position. It is their problem, as it is ours. What is more, they want to increase the trade deficit by maintaining their current steel exports to the United States or by increasing them.

At the same time, they are telling the U.S. coal industry that it must suffer cutbacks in sales of met coal to Japan because its price is not competitive.

The position is intolerable, Mr. Chairman, and it cannot be allowed to stand. Current negotiations which the Japanese and the U.S. Trade Representative have been asked to enter into presents the leverage needed by the coal industry to finally receive good faith bargaining by the Japanese steel industry.

Met coal is a prime ingredient for the production of Japanese steel.

I am sending a letter today to the U.S. Trade Representative that when discussing his "voluntary restraint agreements" with Japan's steel industries, that he negotiate a voluntary bilateral energy trade agreement for the use of metallurgical coal in the Japanese steel industry.

In conclusion, the agreement would restore the American met coal used by the Japanese steel industry at the historical one-third level. The Japanese steel industry is unwilling to enter into this agreement. Strong considerations would be made to reducing the target level of allowable Japanese steel imports into this country.

I might further add, Mr. Chairman, that the Japanese Government has increased their purchases from the Soviet Union of various coal products in the last year, and I find that also quite disturbing.

I thank the Chair, and I thank the witnesses.

[Senator Warner's prepared statement follows:]

PREPARED STATEMENT OF HON. JOHN W. WARNER

Mr. Chairman: I commend you for holding these hearings and for your efforts to balance trade between Japan and the United States.

As the subcommittee heard this morning, Japan's trading surplus with the United States is huge and growing every day.

This surplus is predicted to be over $30 billion for 1984.

$30 billion annually and still growing!

This burgeoning trade surplus is denying jobs to thousands of U.S. citizens.

A mood exists within this country and Congress that, unless Japan takes immediate, positive steps to materially reduce this drastic trade balance, major legislative and/or administrative trade restrictions and sanctions must be imposed on Japanese industries and products.

Increased purchases of American metallurgical and steam coal would be one major way to blunt Japan's burgeoning trade surplus!

This idea of using American energy resources to offset Japan's trade surplus was reflected in the "joint policy statement on energy cooperation" issued after a historic meeting between President Reagan and Prime Minister Nakasone of Japan.

The statement announced that "the countries agree that the sound expansion of United States-Japan energy trade will contribute to the further development of the close economic and energy security which exist between the two countries."

However, increased Japanese purchases of American coal have not been forthcoming.

In fact just the opposite has occurred, American coal sales to Japan have been reduced!

In meeting with the Japanese coal delegation which visited the United States in May, I expressed my strong displeasure. A copy of my May 15 remarks to the delegation is attached as part of my testimony that Japan's purchases of American coal had been reduced while purchases of coal from our competitors had measurably increased.

These increases included an enormous investment in Soviet coal production and a resulting 400 percent increase in U.S.S.R. coking coal sales to Japan!

This investment and increased sales contrasted starkly with that accorded the U.S. coal industry which received no Japanese investment and drastic cuts in Japanese purchases.

To the Japanese coal delegation I stated that to rely on Soviet coal did not bode well for Japan's national security or for the continuation of the traditional mutual defense commitments between our two countries.

The lack of subsequent action by Japan and its energy-consuming industries has done nothing to reduce either the tension over this issue or the veiled threat to the mutual defense commitments.

America's coal interests, anticipating an upturn in coal demand and after listening to foreign buyers concerns including the Japanese, have voluntarily undertaken yeoman efforts to lower the price of U.S. coal to make it more competitive in the world market.

It was my hope that when Japan experienced economic recovery, these measures by making our coal competitive, would be the foundation for new coal sales to Japan.

These new coal sales would reduce our trade deficit and lower trade tensions with Japan.

It has been almost 5 months since the Japanese coal delegation met with Congress.

It appears that Japan is beginning to undergo an economic recovery.

What has been the result of the May meeting?

Has there been any increased coal sales to Japan?

No!

Has there been any recognition by Japanese industry of a responsibility on their part to reduce Japanese trade surpluses through countermeasures—one being the purchase of more American coal?

No!

Quite the contrary, Mr. Chairman.

Repeatedly in the past 5 months, Japanese industry has taken the position that, and I quote:

"The American deficit in trading with Japan is strictly a government-to-government problem and not a concern of private industry."

NOT A CONCERN OF PRIVATE INDUSTRY

And yet, Mr. Chairman, who is it, if it is not Japan's industry who has fostered and benefited from this trade imbalance?

At the fourth Japan-United States Conference on Coal in San Francisco, in an address given by a representative of Kawasaki Steel Corp. it was stated that:

"Directly or indirectly, the United States was the market that significantly contributed to the increase of our exports * * * The recovery and revitalization of the U.S. economy played a pivotal role in the economic recovery not only of Japan's but of the world."

I say to my friends of Japan that America's trade deficit must be of a prime concern to you as it is to us.

The U.S. economy played a pivotal role in your economic recovery, but it appears also that America's trading patterns could reverse your good fortunes.

I would strongly suggest that Japanese trading partners ponder long and hard on this fact.

The recently completed meeting to the United States-Japan Standing Technical Committee on Coal held in Tokyo did nothing to resolve this growing gulf between Japan and the United States.

One learns quickly in negotiations that there is a time for words and a time for action.

The time for words has passed.

Being Mr. Nice Guy has not worked on this issue, Mr. Chairman.

It appears that Japanese industry is unwilling to budge off its arbitrary, unconscionable, head-in-the-sand position and relieve trade tensions.

It is time to take off the gloves, stop the words and take action to resolve this problem.

Last May I indicated that I was leaning very strongly towards advocating the administration to initiate, through the U.S. Trade Representative, significant bilateral energy trading agreement for coal usage.

I am no longer leaning.

I am strongly advocating this action especially with those countries—like Japan—who enjoy a trade surplus with the United States as well as the protection of traditional mutual defense commitments with our country.

Mr. Chairman, within the last 2 weeks the President requested the U.S. Trade Representative to negotiate similar type agreements with steel-exporting countries—including Japan.

The President directed the U.S. Trade Representative to conclude negotiations on a "voluntary restraint agreement" within 90 days with a number of steel-producing nations to reduce the exports of steel to the United States.

Japan, as predicted, criticized President Reagan's decision and the Japanese steel industry stated that they do not believe the trade deficit is their problem.

Furthermore, and more ominously, a Japanese Embassy official warned that any reduction of steel production in Japan would mean a reduced need for coking coal—presumably from the United States.

Metallurgical coal is one of the main ingredients of high quality Japanese steel.

As Japan's steel industry has increased its steel output, it has cut back on purchases of American metallurgical coal.

Japan's steel industry does not believe that the U.S. trade deficit is its problem.

What's more, they want to increase trade deficit by either maintaining their current steel exports to the United States or by increasing them.

SENATOR WARNER'S OPENING REMARKS DELIVERED TO THE OFFICIAL JAPANESE COAL DELEGATION, WASHINGTON, DC, MAY 15, 1984

Mr. Saito, Mr. Masuda, members and observers of the official Japanese coal delegation, as the Senior Senator of the Commonwealth of Virginia, the nation's seventh largest coal producing state containing some of the finest quality metallurgical coal to be found anywhere in the world, I welcome you to Capitol Hill and an open exchange of views with Congress.

There exists an alarming trade imbalance between our two countries. Japan currently enjoys a $22 billion surplus in trade with the United States, and the surplus is threatening to explode to $30–$40 billion in the very near future.

This is denying U.S. citizens jobs and a mood exists within this country and Congress that, unless Japan takes immediate, positive steps to materially reduce this drastic trade balance, major legislative and/or administrative trade restrictions and sanctions must be imposed on Japanese industries and products.

Increased purchases of American metallurgical and steam coal would be one major way to blunt Japan's burgeoning trade surplus.

America, possessing the largest coal reserves in the free world, offers Japan a stable, secure energy source. Our coal provides your country the golden opportunity to reduce your dependence on imported oil and free yourselves from the fear of energy blackmail.

A country's national security is only as strong as its energy security!

A report recently released by the Japanese Ministry of International Trade and Industry, "Long-Term Energy Supply-Demand Outlook and Comprehensive Review of Energy Policy," stated the aim of Japan's energy policy should be to ensure a stable supply of energy.

This aim would be achieved by the following criteria (1) establishing security of energy supply; (2) reducing the energy cost; (3) to establish the best possible energy supply/demand structure with a complete balance maintained between security and cost.

Let me emphatically state that I believe America's coal meets all of the criteria called for by Japan's energy policy.

As our coal strengthens your energy security, there is a corresponding lessening of the economic and manpower burden that the U.S. incurs under its mutual defense commitments with Japan.

Moreover, U.S. coal's quality equals its competition, and our metallurgical coal, particularly that found in Virginia, ranks as the premier coking coal in the world.

Historically, Japan has recognized these facts and maintained a very strong trade relationship with the U.S. coal industry, purchasing, on the average, one-third of its metallurgical coal needs from the United States.

Recently, a very disturbing trend has developed in this strong relationship.

Drastic cuts have been recorded in coal sales between out two countries.

Last year, the U.S. met coal market suffered a 38 percent drop in sales to Japan from that of 1982. The resulting 9.2 million ton reduction in met coal sales caused a loss of at least 5,000 jobs in the U.S. coal fields at a time when our coal industry was

already experiencing rampant unemployment. This lost tonnage also cost the American treasury approximately $591 million in lost revenues, further exacerbating our trade unbalance.

These disastrous cuts occurred at the same time when all other met coal suppliers to Japan, save South Africa, enjoyed enormous increases in sales.

Our steam coal market suffered a worse fate. U.S. steam coal sales to Japan suffered a 43 percent reduction over the previous year, resulting in further increased unemployment and lost revenues. This disturbing treatment accorded one of Japan's strongest allies and an economic partner which contrasts very starkly with that treatment accorded the U.S.S.R.

Japan, during the past year, has purchased an additional 34 percent met coal and an additional 97 percent steam coal from the U.S.S.R. as compared with purchases made in 1982.

This disastrous disparity of treatment was heightened further by a recent announcement in the Japanese news that Soviet coking coal shipments to Japan in fiscal year 1985 would quadruple to 4 million tons and eventually reach yearly sales of 6½ million tons of coking sales by fiscal year 1987.

These additional sales to the U.S.S.R. will occur at the expense of Japan's traditional coking coal supliers— the United States of America. Furthermore, Japan has invested heavily in the development of Russian coal reserves for Japanese consumption while turning a cold shoulder to similar investment opportunities in the United States.

This treatment, if not arrested, does not bode well for Japan's national security or for the continuation of the traditional mutual defense commitments between our two countries.

Talks held with Japanese coal buying industries have made me aware that these industries are currently facing very trying economic times.

These times do not offer great promise for increased coal sales to Japan now:

(1) Large stockpiles of met and steam coal exist throughout Japan.

(2) A national and international recession has struck Japan hard lowering its electrical consumption and steel production.

(3) Investments in coal reserves in countries other than the United States are coming on stream—adding to Japan's coal glut.

Notwithstanding these current factors, America's coal, which many agree is not price competitive, does not stand to share in any increased coal sales to Japan when the economic situation improves.

It is my emphatic hope that as Japan's economic situation improves, and American coal becomes price competitive that Japan's industries will make commitments with U.S. coal industry—both met and steam—restoring our traditional one-third of Japan's market and correcting the recent unfortunate treatment. Anything less would seem to indicate that Japan's buyers had not been negotiating in good faith.

Those involved in the American coal industry, have undertaken monumental steps in the past few years to make our coal price competitive, and these efforts continue unabated.

These efforts have resulted in:

(1) Increased productivity at the mine;

(2) Reduced government regulation;

(3) Improved coal port capacity and facilities;

(4) Legislation to improve our inland waterway system and deepen our coal ports;

(5) Improved inland railroad transportation system; and have gone a long way towards making our coal price competitive.

However, U.S. coal buyers have repeatedly told me that it is their feeling that rates set by America's coal hauling railroads are the major reason for not being competitive, resulting in lost sales to our competitors.

Concerned about this perception of our buyers, I discussed with the two coal hauling railroads located in my state the possibility of correcting this misperception.

I am very pleased to announce today that I have in hand a response which I believe will meet our coal price competition worldwide and will be the foundation for increased coal sales between out two countries.

I quote from one of the letters:

"As evidence of our continuing commitment to U.S. coal exports, I am writing to tell you that the CSX railroads would be willing to offer rate reduction on volume coal shipments to Japanese steel mills, to guarantee these reduced rates for one year, and to limit future rate increases to inflation costs only."

The railroads have responded to our international buyers concerns about price competitiveness.

They have met the terms you have set for entering into a long-term coal sales contract.

They have given you a golden opportunity to purchase a stable, secure supply of energy at a competitive price. The next move to reduce trade frictions between our two countries is up to the Japanese industry.

I, and the rest of Congress will be watching very closely the talks next week in San Francisco and beyond, to see if the railroads good faith efforts and offer of competitive price are matched by the Japanese industries' offer of increased sales of U.S. coal under long-term contract.

If not, trade restriction pressure will be significantly and substantially increased.

It is my fervent hope that the industries of our two countries can voluntarily enter into private coal sales contract, based on today's railroad announcements, free from government interference.

Senator MURKOWSKI. Thank you very much, Senator Warner.

That observation was brought out in earlier testimony, and also that Japan has financed certain coal development projects in China.

So indeed we have a growing problem, and we very much appreciate your input and testimony today. It has been a very valuable addition to the record.

Thank you, and good day.

Senator WARNER. Thank you.

Senator MURKOWSKI. I might ask you, Mr. McCoy, since you represent on one hand the Coal Exporters Association, and on the other, a private company, in your opinion, is there anything to be gained by pursuing, in cooperation with others who are in the energy business, the development of an energy caucus as opposed to the conventional coal caucus other in the Senate or related caucuses?

It seems like we have a broad opportunity here in the sense of marketing energy. Coal, gas, and oil are all energy. Can we market our energy better through a common and united effort as opposed to each one competing with each other for a share of the marketplace?

Do you have any opinions on that?

Mr. MCCOY. No, I really do not have an opinion on that.

I would like to say in broad terms that these are trade issues that the Government is dealing with, and the Government has to pull together the right pieces to resolve the trade imbalance issue. And coal wants to play its part, coal believes it can be a major contributor, and I think that is certainly a decision of the administration to pool all of these resources together to optimize the trade balance situation.

Senator MURKOWSKI. We have heard that as a result of the Reagan/Nakasone energy communique that Vice President Bush was left with the task of coordinating and implementing some of the recommendations that came out of the United States-Japan Energy Working Group.

Do you have any feeling for just where that responsibility might be, or do you know if it has been delegated down?

Ms. HOLMES. I believe, sir, that that has been delegated from the Vice President's Office to the State Department.

Senator MURKOWSKI. The State Department?

Ms. HOLMES. I believe so.

Senator MURKOWSKI. Do you have any reason to feel optimistic about what might come out of the State Department since they have evidently been given the responsibility?

Ms. HOLMES. We were quite disappointed of course, that the implementation of the Reagan-Nakasone agreement would be relegated from the highest administration levels to another department, but I think that if State, Commerce, the STR, the National Security Council all working together through the United States-Japan Energy Working Group, can encourage the Japanese Government in the directing of U.S. coal and bring out the results of their work through the Vice President and through the President, that we will still have some success.

Senator MURKOWSKI. What agencies do you feel most frustrated with, whether it be Commerce, State, or the Trade Representative, in terms of the lack of Government assistance to initiate long-term coal contracts?

Where do you feel that the real stumbling block is, and what suggestions might you have to expedite the process within these agencies?

Ms. HOLMES. That is a hard question to answer.

All of the different groups that are working on this particular problem have not only coal, of course, but a lot of other things to be concerned about. We believe that all of the groups involved are making the best efforts to implement the agreement in the best way possible for each agency. Each agency has to take a different approach to assist the coal industry.

I know again the National Security Council was most instrumental in helping us, in meeting with the Japanese in May. The Commerce Department has taken a very firm lead role in the area of coal, as has State, in the United States-Japan Energy Working Group.

Frankly, we have heard less from the STR's Office than from any other group involved in the workings of the United States-Japan Energy Working Group, but I will say that at times it does not seem as if all of the various parties to that group are working together for the common end, which is to export more U.S. coal.

I would refer specifically to some of the decisions that have been made by an independent regulatory body the ICC, in the area of rail rates of late, and that has been a problem.

Mr. MCCOY. Mr. Chairman, my activities in the coal export business have been mainly commercial and not too involved in the Government political scene, and my frustrations are those that we have tried everything to be more competitive, and we have taken measures in the private industry to reduce our coal prices, to reduce the transportation. And this oversupply of coal that exists in the market and the market share going to Australia, South Africa, despite all of the efforts that we have taken, leaves the private industry somewhat bewildered, and that is why we are asking for more Government help on these issues.

Senator MURKOWSKI. I want to comment on that because I think we frequently look to Government for a magic solution, and it is my observation that unless you very carefully tailor and propose a solution to Government, more often than not you are going to be disappointed with the results. Although there are a lot of well

meaning individuals in the various agencies that would like to see the situation resolved, their effectiveness is limited because of questions of who coordinates the effort, who develops the plan, and who systematically sets up the priorities and delegates the responsibility of how you get from here to there. You do not do it overnight. It becomes a gradual commitment of policy that must have continuity and at some point an accountability factor.

It appears from the testimony we have had today that there are a lot of well-meaning efforts going on. But we still have not presented a specific plan of how we are going to accomplish our energy export goals.

Would you share that general observation?

Mr. McCoy. My observation is one that you must encourage the Japanese to look toward the United States as far as natural resource supply because of the economic ties between the two countries. You cannot preach, you cannot dictate Japanese policy. That is for the Japanese to decide. There just has to be a strong level of encouragement that the well-being of future trade between the United States and Japan will be served by improving the amount of natural resources that they import from the United States.

Senator Murkowski. I think we have pretty well covered the prepared questions that I have had, and I want to thank you for your contribution to the record.

Without objection, I would like to include in the record a background paper on issues addressed in the hearing today. The paper was produced by the Congressional Research Service at the subcommittee's request.

[The information referred to follows:]

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

October 1, 1984

TO : Senate Foreign Relations Committee
Attention: Mary Locke

FROM : Gary J. Pagliano
Specialist in Energy Policy
Environment and Natural Resources Policy Division

SUBJECT : Hearings on U.S.-Japan Trade; Prospects for Coal

This responds to your request for a briefing paper on the major U.S.-Japan trade issues for upcoming hearings by the Subcommittee on East Asian and Pacific Affairs. Particular focus will be reasons and issues surrounding the continuing rise in the U.S.-Japan trade deficit; and the possibility of increasing U.S. coal exports to Japan to lessen the deficit.

AN OVERVIEW OF U.S.-JAPAN TRADE

The U.S. trade deficit with Japan and indeed, the rest of the world continues to increase at significant rates. In April 1984, the U.S. economy generated a record $12 billion trade deficit, leading the U.S. Department of Commerce to predict a $130 billion trade deficit total for the rest of the year, almost double the $69.7 billion deficit of last year (1983).

Most analysts agree that the main causes of the deteriorating U.S. trade position are: 1) the continued strong dollar resulting in expensive U.S. goods and services (exports) sold abroad and cheaper U.S. imports of foreign goods and services; 2) continued U.S. economic growth which is outpacing most economies of other industrialized countries, thereby increasing the demand for foreign imports in U.S. domestic markets, while demand for U.S. exports in these countries stagnates or increases at much lower rate; and 3) the debt service problems of developing countries causing them to reduce expenditures for foreign goods and further reducing the demand for U.S. exports.

U.S. exports to Japan are expected to pick up during 1984 as Japan's economic recovery continues, but faster U.S. growth and a continued strong dollar should spur an even greater increase in U.S. imports from Japan and thus widen the trade deficit. The U.S. trade deficit with Japan which was $21.7 billion in 1983, is projected by Data Resources, Inc. (DRI) to increase to $31.1 billion in 1984 and $35.6 billion in 1985 (see Appendix I).

Concern over the trade deficit over the last four years has resulted in extended U.S.-Japan negotiations and the formation of joint working groups to address a number of issues which U.S. leaders argue would make U.S.-Japan trade relations more equitable and probably reduce the trade deficit. While Japan has taken steps to address these issues, such as reducing some of its tariffs and committing to internationalize its currency, U.S. leaders argue Japan could do much more, particularly in reducing its market barriers to U.S. industry.

Trade Initiatives

The impetus for the latest round of U.S.-Japan trade initiatives was the November 1983 meeting between President Reagan and Prime Minister Nakasone. At this meeting, it was agreed to convene a new round of international trade negotiations; to create a bilateral investment committee to liberalize rules on foreign investment on Japan; to work toward the internationalization of the yen in seeking a solution to the dollar/yen exchange issue; to continue cooperations in high technology trade; and to work for improved access to Japan's market for foreign goods.

The two leaders also agreed to implement the recommendations of a U.S.-Japan Energy Working Group encouraging Japan's industry to purchase U.S. steam coal to meet future new demand. Japan pledged that imports of competitively priced U.S. metallurgical coal would not decline further and that its steel industry would be encouraged to increase imports of U.S. coal when industry conditions permitted.

One result of these negotiations was Japan's fifth and latest trade liberalization package, announced in April 1984. It contained tariff reductions and renewed commitment to increase imports of manufactured goods. The package also contained further simplification of Japanese standards and certification systems for imports, including procedures whereby foreign laboratories would be approved for product testing, and the liberalization of the distribution system for foreign cigarettes. Foreign investment in Japan was further encouraged, and the Office of Trade Ombudsman was expanded to handle investment complaints.

Individual Product Agreements

Since the beginning of 1984, there have been three major agreements improving U.S. access to Japan's markets.

Telecommunications. The Nippon Telegraph and Telephone (NTT) procurement agreement was renewed in January for another three years, providing improved U.S. supplier access to a $3 billion market. Also, U.S. companies will now be afforded equal access to bid on NTT's research and development activities.

Agricultural Products. A new four-year (FY 1984-87) agricultural agreement provides for annual increases of 6,900 metric tons in the quota for U.S. beef, 11,000 metric tons for oranges and 580 metric tons for orange juice. The quota on grapefruit juice will be eliminated in 1986.

Semiconductors. The Ministry of International Trade and Industry (MITT) has committed itself to increasing sales of U.S. semiconducters. A proposed restriction on foreign ownership of companies providing Value Added Network (VAN) services was eliminated.

SPECIFIC TRADE ISSUES

Yen/Dollar Exchange Rate

Experts argue that increased internationalization of the yen would increase demand for the yen and increase its foreign exchange value

relative to the dollar. Months of negotiation in seeking ways to internationalize the yen resulted in a U.S.-Japan agreement in which Japan would: 1) provide for the creation of a Europyen market; 2) further deregulate Japan's interest rates; and 3) improve access to Japan's capital markets for foreign institutions (see Appendix II for specifics of the agreement). Most analysts believe the liberalization measures will ultimately increase the yen's use in international trade and finance, and consequently, the demand for the yen, contributing to an appreciation of the yen. It is not possible to estimate how soon this effect might occur or how large it will be.

The liberalization measures are, however, only one of many factors affecting the demand for the yen. Relative interest rates in Japan and abroad and differences in savings rates among the major industrial countries, in particular, probably have a far larger effect on international capital flows and the demand for the yen than do the liberalization measures. For example, recently interest rates in Japan have been substantially lower than those in other countries, while the Japanese savings rate has been higher than savings rates abroad. The large net long-term capital outflows from Japan in the April-June 1984 quarter and the recent depreciation of the yen against the dollar indicate the higher interest rates in the United States relative to interest rates in Japan and the higher Japanese savings rate may be the most important influences on the dollar-yen exchange rate in the short-run.

In addition even if a significant currency realignment takes place, it might well, some argue, make a little difference in the U.S.-Japan bilateral

trade balance for the following reasons. First, 60 percent of Japan's imports from the world are food and raw materials, which are less responsive to price changes. This relative resistence to price change would mean little change in demand for over 30 percent of U.S. exports to Japan. And second, many U.S. products are already price competitive with Japanese products at current yen/dollar exchange rates; but these U.S. products have a far lower share of the Japan market than is typical in other foreign exports markets. U.S. officials argue this is because U.S. products still face formal and informal trade barriers in the Japanese markets.

Further Access to Japan Markets

While some market access has been granted to some U.S. products, there are still many issues of access that remain. They fall into two categories. First, virtually every aspect of the Japanese agreements and trade initiatives, will require intensive follow-up so that market access actually materializes. Included are such Japanese sectors as tobacco and telecommunications services where legal reforms are currently just underway to create greater access for foreign products. These reforms could face prolonged legal tests as they are implemented through the Japanese bureaucracy. Second, issues only partially addressed or not at all by the Japan Government will require new efforts. These areas include: 1) reducing tariffs on more U.S. products such as forest products; 2) doing more to encourage foreign direct investment in Japan such as giving U.S. investors national treatment except in national security areas and

a few restricted sectors (mining, agriculture and petroleum refining); and 3) seeking changes in Japanese law which would enable U.S. lawyers to provide legal advice on U.S. and international law, just as Japanese lawyers in New York are able to provide advice on Japanese and international law (see appendix III for a U.S. government analysis of individual requests and agreements on U.S.-Japan trade).

COAL

World coal trade, after stagnating in 1982 at 299 million tons (mt), and then declining by 6.5 percent in 1983, is expected to improve only slightly in 1984, and only in steam coal. The main reasons for this are: 1) low growth rates in world elecricity demand; 2) only some recovery in the world iron and steel industry; 3) uncertainties and competition caused by lower "real" (after inflation) oil prices; and 4) continued high levels of stockpiles, built up in 1980 and 1981 as reserves for delays of supplies coming from Australia and Poland. With 1982 levels of coal trade probably unreachable until 1985, competition among suppliers continues to intensify with some market share reordering taking place.

In the Pacific rim market, Australia, the lowest cost supplier in this market, and Canada are gaining market shares while the U.S. is losing some. In the West European market, South Africa, the lowest cost supplier in this market, and Poland are gaining market shares, while again, the U.S. is losing some. All told, U.S. coal exports, after plunging to 70 mt in

1983 from 95 mt a year earlier, are expected to stabilize or increase slightly in 1984.

U.S.-Japan Coal Trade

Current trends show that U.S.-Japan coal trade could exacerbate the overall balance of payments problem that now exists between the two countries. Japan's purchases of coal have dropped significantly over the last two years particularly in metallurgical grade coal. Purchases in 1983 dropped to 14 million tons (mt) from 20 mt the year before, with shipments projected to stabilize or show a small decline in 1984, and potentially a greater decline in 1985. The major cause of the possible decline is that U.S. coal is too expensive. Reasonably secure sources in Australia, South Africa, and Canada are out-competing U.S. coal suppliers in a market sensitive to the overvalued dollar, and are seriously threatening to claim an even greater share of the market in the future as they expand their production capacity. One estimate projects that total U.S. coal exports to the entire Pacific Rim may be only 2 mt by 1990.1/

Japan's government has been pressuring its industries into buying U.S. coal to help the bilateral trade deficit and honor a pledge that Prime Mininster Nakasone gave to President Reagan that Japan would do its best to keep metallurgical purchases at 10 mt annually. It will be difficult to accomplish this goal however, because even with Japan offering to pay

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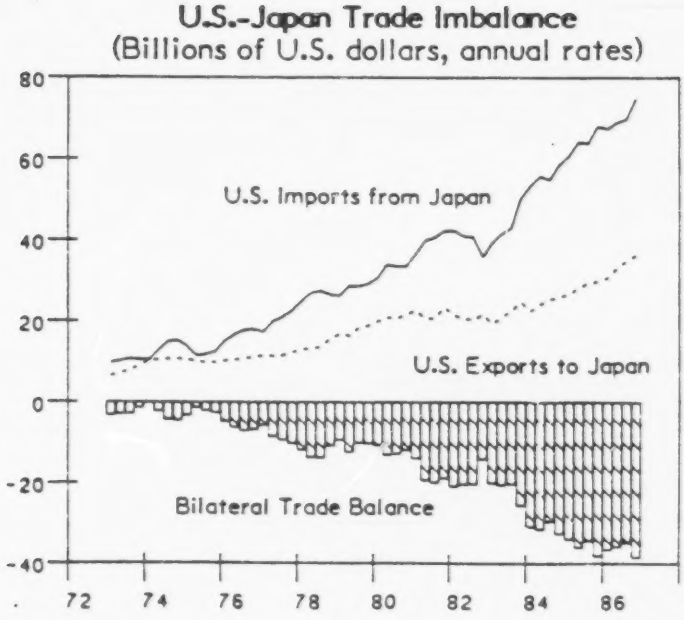
1/A Gritty Future For U.S. Coal Exporters. Business Week. February 27, 1984. pg. 60.

more for U.S. coal than they would pay for the same grade elsewhere, the price is not high enough to keep U.S. companies, particularly smaller companies, in the market. Reducing the delivered cost of U.S. coal to Japan implies that producer prices and transportation costs, particularly U.S. rail-rates, also be reduced.

It has been suggested that U.S. coal producers, railroads and coal consumers might look into a long-term contractual arrangement with escalation clauses fair to all so that the railroads would then become willing to exchange price cuts for sizeable amounts of guaranteed tonnage. It has also been suggested that the U.S. try to promote coal exports by offering buyers coal utilization technology along with the coal. The Department of Energy has allocated $235 million on research and development on a new generation of clean, efficient coal-burning systems. However, market forces such as competition from foreign coal sources seem to be undermining the creation of any significant initiatives in this area.

Appendix I



Source: Data Resources, Inc.

Composition of U.S.-Japan Trade and
Principal U.S. Trade Items with Japan
1978-1982, Jan-July 1983-1984

U.S. Exports	1978	1979	1980	1981	1982	Jan-July 1983	Jan-July 1984
(billions of dollars)							
Total	12.9	17.6	20.8	21.8	21.0	12.0	13.7
Agricultural	4.4	5.3	5.1	6.6	5.5	3.3	4.0
Nonagricultural	8.3	12.2	14.5	15.0	15.1	8.5	9.5
Manufactured	4.8	7.0	8.6	9.5	9.4	5.6	6.4
(millions of dollars)							
Coal	575	915	1,311	1,472	1,525	591	556
Chemicals	502	851	987	1,215	1,303	1,445	1,704
Corn	917	1,203	1,633	1,792	1,290	898	1,283
Logs & Lumber	1,087	1,744	1,533	1,021	1,045	531	525
Soybeans	981	1,032	1,106	1,139	971	653	752
Aircraft & Parts	404	856	1,086	1,310	906	776	643
Office Machinery & Computers	369	483	652	759	838	487	599

U.S. Imports	1978	1979	1980	1981	1982	Jan-July 1983	Jan-July 1984
(billions of dollars)							
Total	24.5	26.3	30.7	37.6	37.7	22.7	33.3
Agricultural	0.1	0.1	0.1	0.1	0.1	.9	.1
Nonagricultural	24.4	26.2	30.6	37.5	37.6	22.6	33.2
Manufactured	23.9	25.7	29.9	36.9	36.9	22.2	32.3
(millions of dollars)							
Passenger Cars, New	5,735	6,664	8,359	9,324	9,169	5,961	7,326
Steel Mill Products	2,347	2,660	2,843	3,801	3,586	994	1,776
Consumer Electronics	1,789	1,431	1,540	2,479	2,404	1,477	2,620
Trucks and other Motor Vehicles	121	402	788	2,170	2,219	1,368	1,741
Electrical Machinery & Parts	1,207	1,373	1,678	1,974	2,197	1,578	2,794
Office Machinery & ADP Machines	949	970	1,175	1,656	2,102	1,748	3,100
Metal Manufactures	982	979	1,036	1,140	1,334	577	778
Motorcycles & Parts	816	900	1,227	1,297	1,069	492	431

Note: As total U.S. export figure includes reexports, agricultural and nonagricultural exports will not add up to that total.
Exports are valued f.a.s.; imports are valued on a customs value basis (excludes freight, insurance, and any duty)

Source: U.S. Department of Commerce, Bureau of the Census

Revised 9/6/84

Appendix II

May 29, 1984

BACKGROUND PAPER ON REPORT ON YEN/DOLLAR EXCHANGE RATE ISSUES

The report on yen/dollar exchange rate issues released today by Secretary Regan contains important measures and commitments with far-reaching implications for the U.S. economy, the Japanese economy, and the international economic and financial systems.

The policy changes announced by Japan will occur in three broad areas: the Euroyen market, the operation of Japan's domestic capital market, and the access of foreign financial institutions to the Japanese capital market. Outlined below are some specific steps that are being taken in each of these areas:

Development of the Euroyen Market

This is the area most important to the internationalization of the yen -- increasing the use of the yen as an international investment and transactions currency. The Ministry of Finance has, in this report, announced the basic commitments and decisions necessary to allow for the development of Euroyen bond and banking markets, where non-Japanese can freely invest in or borrow a range of yen-denominated instruments.

Specifically, in the Euroyen bond market:

-- effective December 1, 1984, the number and types of issuers of Euroyen bonds will be expanded significantly with the result that any borrower meeting credit criteria can issue. Of particular importance is that non-Japanese corporations will for the first time be able to issue yen-denominated Eurobonds. The credit criteria initially applied will parallel those in the Samurai market -- that is, the domestic Japanese market for foreign yen bond issues. However, these credit criteria will be further liberalized from April 1, 1985 to permit any borrower rated AA or better as well as a reasonable portion of those world corporations that would be rated A to issue such bonds.

-- These corporations, as well as all other foreign issuers of Euroyen bonds, will face no restrictions on the number or size of issues, and will not be required to use the Samurai market as a prerequisite. Attached to the report is an appendix which sets forth the characteristics of the Euroyen bond market.

-- We believe these characteristics can provide the framework for the development over time of a fully functioning Euroyen bond market.

Source: U.S. Department of the Treasury

-- As part of this Euroyen bond market liberalization, effective December 1, 1984, all guidance, restrictions or requirements on the choice of lead managers of Euroyen bond issues by both Japanese residents or nonresidents will be removed. All firms engaged in the business of underwriting securities, in or out of Japan, will be able to participate fully in the Euroyen bond market. This opens up a significant new area of business for foreign firms.

Another important aspect of the development of a Euroyen market is the development of a Euroyen banking market. Two major steps are being taken toward this end:

-- By the end of 1984, foreign and Japanese banks will be authorized to issue from their offices outside of Japan short-term negotiable Euroyen certificates of deposit. This will provide an important funding base to the Euroyen banking market as well as an attractive short-term investment instrument. As with the Euroyen bond market, the report spells out the characteristics of this market, stating clearly the absence of any restrictions except for a maximum maturity of six months, and a prohibition on sale to Japanese residents.

-- On the lending side, as of June 1, 1984, Japanese and non-Japanese banks will be free to extend Euroyen loans to non-residents. There will be no limits on the amount or timing, and no prior approval required. While the development of this market may be somewhat limited initially by the restriction that Euroyen loans by Japanese banks must have a maturity of one year or less, it is the Treasury's understanding that no maturity limitations will apply to Euroyen lending by non-Japanese banks. Thus we believe that there is considerable potential under these new policies for the development of a major Euroyen banking market.

While most of our focus has been on Euroyen bond issues by non-Japanese residents, such as U.S. corporations, the Ministry of Finance has also liberalized its policies concerning Euroyen bond issues by Japanese residents, in particular by increasing the number of firms eligible to make such issues. We welcome these steps but believe that in order for such issues to be competitive and attractive to international investors, it will be necessary to remove the withholding tax applied to earnings by non-residents on investments in Euroyen bonds issued by non-Japanese residents. Accordingly, the Ministry of Finance and the Treasury have agreed to expedite a study to solve this problem.

These commitments and measures in the Euroyen bond and banking market represent a fundamental and significant development in the internationalization of the yen and the use of yen by firms and individuals throughout the world. We believe that when these and other policies outlined in other sections of the report are fully in place, the yen can evolve to a role in international finance commensurate with Japan's role in the world economy.

Liberalization of Japan's Domestic Capital Market

Substantial changes in domestic financial market policies were also announced by the Ministry of Finance. The Ministry affirmed its intention to continue the process of liberalizing Japanese capital markets. The report points out that allowing the free play of market forces to allocate financial resources will enhance economic efficiency in Japan and the world as a whole.

The Ministry of Finance agreed that removal of controls on interest rates was central to the overall process of financial liberalization. To further interest rate liberalization, it was agreed the Ministry of Finance will seek to:

-- Relax and remove interest rate ceilings on large denomination deposits in two to three years.

-- Permit banks to sell new types of large denomination deposit instruments with market determined interest rates by April 1985.

-- Lower the minimum denomination of domestic certificates of deposit and enlarge further the ceiling on each bank's CD issues. Restrictions on CDs will be eased further in the future.

In addition, a number of measures are being announced in a variety of areas related to the operation of Japan's domestic capital markets:

-- Qualified non-Japanese banks' offices in Japan will be allowed, for the first time, to trade Japanese government securities, a change which will enhance further the development of the secondary market in government securities, and provide an important opportunity for U.S. firms qualified in this business.

-- The Ministry of Finance abolished effective April 1984 nonprudential limits on overseas yen lending from Japan by Japanese and non-Japanese banks. This should allow for a substantial increase in international lending from Japan denominated in yen.

-- Also, effective April 1984 limits on foreign banks' share in overseas syndicated yen lending from Japan have been eased and they will become eligible to be lead managers and agents.

-- The Ministry of Finance will by the end of 1984 establish a concrete scheme for the creation of a yen-denominated banker's acceptance market.

-- The limits on oversold spot foreign exchange positions -- swap limitations -- will be removed effective June 1, 1984. This will increase the range of funding sources available to foreign banks.

We believe that these changes in Japan's domestic capital market will allow market forces to play an increasing role in that market, promoting a more efficient allocation of capital that will not only benefit Japan but the entire world economy. They will also make yen-denominated instruments more attractive to non-Japanese, thus furthering internationalization of the yen.

Access by U.S. and Other Foreign Financial Institutions to the Japanese Capital Markets

The Ministry of Finance also announced a number of important changes pertaining to the ability of foreign financial institutions to do business in Japan and compete on an equal footing with Japanese financial firms. These will help ensure that foreign financial institutions have equal effective competitive opportunity in Japan, and reflect the Ministry of Finance's commitment to the principle of national treatment.

-- For the first time qualified foreign banks will be licensed to participate in the same range of trust banking activities as is now performed by Japanese trust banks. This should provide an important new opportunity for U.S. firms operating in Japan.

-- The Minister of Finance has requested the Tokyo Stock Exchange to study ways of providing opportunities of membership to foreign and domestic non-member firms, including by revision of the existing system. While this study is underway, the Ministry of Finance has stated that it is prepared to assist non-Japanese securities firms in efforts to join the Tokyo Stock Exchange under the existing system.

-- In an effort to improve the transparency in the regulatory environment, which is a major factor affecting the ability of foreign financial institutios to operate successfully in Japan, the Ministry of Finance expressed its commitment to continuing to promote transparency in the execution of its policies. A number of announcements within the report will increase the degree of transparency in the implementation of policies. These include the announcement by the Ministry of Finance to eliminate completely swap limits (controls on the amount of foreign exchange that could be converted into yen for use in Japan), to liberalize policies governing overseas lending, and to clarify the policy on brokerage requirements in the bill discount market.

These new policies together with other announcements contained in the report will provide significant impetus to the internationalization of the yen and the liberalization of domestic capital markets. It is expected that the effect over time will be to permit the yen to reflect more fully its underlying strength.

Senator MURKOWSKI. I would also like to advise you that we will keep the record open for 10 days for additional questions and inserts.

In conclusion, I think that your testimony has indicated that indeed American coal is cost competitive under certain situations, and we look forward to you providing for the record more information on steam coal.

Mr. MCCOY. Mr. Chairman, may I clarify? In responding to that, I will submit comparative prices for steam coal from the United States, and generally what they will show is that in the spot markets we are not competitive with South Africa, with Australia because of their cheaper labor position and the investment by Japan, but we will be able to show that in specific instances that there are projects that steam coal is supplied to Japan at higher prices than from the United States.

Senator MURKOWSKI. The other point that you brought up is the situation with regard to the lack of long-term contracts with U.S. coal exporters, which puts the United States in a position as a swing supplier.

If we are going to accomplish anything meaningful in the area of coal exports to Japan, it is going to have to involve the initiation of long-term contracts.

Additionally, the issue of the transportation is probably appropriate to address. You have indicated the inappropriate action of the ICC in establishing internal rate structures on the railroads.

What was the reference to that?

Ms. HOLMES. Yes, I did reference the ICC.

Senator MURKOWSKI. The utilization of coal slurry pipeline and other technology and the right of Federal eminent domain are necessary provisions if we are to move forward and be competitive. We are aware of the role American industry has been playing in providing coal slurry technology to China, and China indeed may well at one point be a major coal exporter and competitor as well as coal consumer.

And I think last, the missing ingredient really is the willingness on the part of the Japanese to recognize the interrelationship between the trade deficit and the issue of coal trade, and thus, their unwillingness to take the necessary steps to provide long-term contracts or the equity investments to support competitive coal projects.

From your testimony we have garnered for the record the position currently of the coal industry and indicated specific ingredients necessary to turn around and offset the trade deficit we have with Japan.

I want to conclude this hearing by indicating again that the record will be open for 10 days. I would also like to mention that I intend to hold hearings on other specific trade issues with Japan and other nations where we are developing an increasing trade imbalance to see if we cannot generate positive recommendations to provide relief. I intend to watch the legislation that has been proposed to set up the new Department of Trade, and again, I am extremely concerned with the lack of accountability for trade policy formulation and implementation. I am concerned that some agency be given the responsibility for our trade policies once they are

clearly defined and that this agency be held accountable. This is going to be a big order because, as has been pointed out in the testimony, the State Department, the Department of Commerce, the Trade Representative's Office are going to have to exchange some of their areas of responsibility, something easier said than done.

If this effort is going to work, there is going to have to be some streamlining and centralization of responsibilities. Ultimately I think the administration, perhaps through the appropriate input of Congress, is going to have to develop a plan to achieve this.

I would again thank those of you who have participated in the hearing and those that have observed, and I wish you all a good day.

The hearing is now adjourned.

[Whereupon, at 3:10 p.m., the subcommittee adjourned, subject to call of the Chair.]

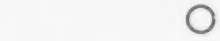
APPENDIX

STATEMENT OF DAVID J. STEINBERG, PRESIDENT U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, ALEXANDRIA, VA

(The U.S. Council for an Open World Economy is a private, non-profit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

The United States—the government, the business community, the labor movement and all who are interested in American economic growth, open international commerce, sound international development and the overall national interest—should press for progressively freer U.S. access to the Japanese economy. Japan is much more "protectionist" than a country so economically advanced has a reasonable basis for being. Japan should in fact be playing a leadership role in the effort which all the advanced countries should be making to achieve a more open world economy. With astute strategy and proper tactics on the part of the United States, much can be accomplished toward eliciting greater Japanese cooperation in this endeavor. With the right strategy and tactics, much more can be done toward this objective than current U.S. policy seems capable of achieving. However, the strategy and tactics needed for this kind of progress are not yet in place.

Current efforts at securing greater U.S. access to the Japanese market (aside from counterproductive tactics such as "reciprocity" ploys that would tend to ratchet trade barriers still higher) are suitable as short-run devices for lowering somewhat Japan's import restrictions. However, the prospects for wide, deep and sustained reduction of Japanese impediments against U.S. goods, services and investment are greatly restricted by lack of a coherent, comprehensive strategy for programming the removal of all artificial barriers by both Japan and the United States—ultimately free trade itself—within the framework of a multilateral, free-trade strategy affecting U.S. commerce with the world economy as a whole. The United States should invite all the economically advanced countries to participate with us in forming a free trade area under the General Agreement on Tariffs and Trade, with the clear implication that those countries not joining would be denied the special treatment accorded one another by those that did participate. (The world's developing countries would be given special privileges in this free trade area and be required to assume special responsibilities consonant with their economic capabilities.) Each participating country would be impelled to have a domestic adjustment and redevelopment policy to backstop its commitment to the rules and timetable of the free-trade charter. Such a domestic strategy is essential to making the free-trade policy politically palatable. In our case, what is good for the nation as a whole must be made good for every state in the Union.

A definitive, explicitly free-trade strategy, involving far-reaching commitments not only by Japan but by the United States and as many other advanced countries as agreed to participate, would conceivably engender impressive reforms in Japanese attitudes toward the world economy and toward Japan's role and responsibilities in the world economy. Anything significantly short of the free-and-fair-trade charter which I have advocated in many forums would leave Japan in its present state of profound uncertainty over what the United States and other advanced countries may have in store for Japanese exports as international competition gains in intensity. This uncertainty and concurrent feelings of national insecurity may have contributed significantly to Japan's reluctance to be more forthcoming in reducing barriers against foreign goods, services and capital. Substantial reform of the domestic cultural and political obstacles retarding adoption of more-open policies in relations with the world economy will require a much more dynamic, more far-reaching trade initiative than the United States of virtually its entire "liberal trade" community has thus far advocated.

Obviously, such a policy initiative will take time to "sell" to Congress and the American people, and time to persuade Japan and our other trading partners even to consider. Thus, our Council is not advocating it as an alternative, but as a longer-range supplement, to the conventional tactics now pursued in seeking freer access to the Japanese market. However, we should have no illusions about the prospects for substantially and continuously freer access to the Japanese economy through the kinds of pressures and threats that for too long have characterized U.S. approaches to Japanese authorities on trade issues. Japan is much more likely to move impressively toward open trade with the world within the framework of a charter in which all participating commerce than in response to the kinds of overtures the United States and other advanced countries have been orchestrating. I invite those who find "reciprocity" to be an appealing standard for trade-policy formation to ponder the fact that the policy strategy I am advocating projects the ultimate in progressive reciprocity—the programmed removal of all foreign-economic obstructions by those countries with the economic capabilities to go this route.